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MERCANTILE CREDIT

BY

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PREFACE

THIS volume represents an attempt to discuss one branch of the credit family, Mercantile Credit. The theory of credit, and the different kinds of credit are considered only in so far as the treatment of these subjects makes more clear the nature, scope, and functions of mercantile credit. Bankruptcy legislation has to do largely with those who give and those who receive mercantile loans, and for this reason it has been considered of sufficient importance to warrant treatment.

While treating mercantile credit from a theoretical standpoint, an attempt is made to view the problems of mercantile credit as far as possible as a business man would view them. For this reason the author has described with much detail the work of the credit man, the organization of his office, the sources of credit information, the forms he uses to secure this information, and the principles which govern him in the granting of credit. He also discusses at considerable length the development of legislation with reference to credit, and the attitude of credit men toward this legislation.

Since economic phenomena should be viewed in the same way as phenomena in any other science, it is the first task of the economist to state clearly and to describe accurately the facts which come within the scope of his

investigation and then interpret them in the light of economic knowledge. In this volume the author has attempted to do this.

This book is intended primarily for students in the colleges or schools of commerce, for those engaged in the many phases of credit work, and also for those who are interested in the general subject of credit.

Chapters IV, VI, VIII and XIV were published in whole or in part in the American Journal of Accountancy, and acknowledgement is made to the editors of this magazine for their courtesy in permitting the use of the material of these chapters in this volume. The writer acknowledges his indebtedness to his colleagues in the Department of Economics and Sociology of the Ohio State University for helpful criticisms, and especially to Mr. B. G. Watson, the secretary of the Columbus Credit Men's Association, who read several chapters of the manuscript and offered many helpful suggestions.

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OHIO STATE UNIVERSITY, COLUMBUS, OHIO.

June, 1913.

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PART I

**ORIGIN, DEVELOPMENT AND PRESENT
STATUS OF MERCANTILE CREDIT**

CHAPTER I

THEORY AND HISTORY OF CREDIT

No economic term has been given a greater variety of meanings, even by economic writers, than the term credit. This fact makes it important at the beginning of an economic study to state clearly the meaning which the term is intended to convey. For purposes of the present discussion, credit means "the power to secure commodities or services at the present time in return for some equivalent promised at a future time."¹ Closely allied to the meaning of credit is a credit transaction which is "a transfer of goods, services, or money, for a future equivalent."² The credit system may be defined as the great variety of means by "which transactions in credit are conducted, and the tremendous volume of debts and credits are brought into being, passed from hand to hand in the routine of business, and finally liquidated."³

Defini-
tions.

In the business world a man has good credit if he always pays his debts when due. To the bookkeeper credit means that something is owed on an account.⁴ Credit is given people in general when they do some-

¹ C. J. Bullock: *Introduction to the Study of Economics*.

² Ely: *Outlines of Economics*.

³ Prendergast: *Credit and Its Uses*.

⁴ Johnson: *Money and Currency*.

thing upon which society places a favorable estimate. Among the economists we also find a variety of definitions: Mill defines credit as "the permission to use another's capital." Macleod defines it as "the present right to a future payment." Fawcett defines it as "the power to borrow money." Laughlin defines it as "machinery invented to aid in accomplishing the purposes of capital." The differences of opinion among the economists as suggested by these definitions are more apparent than real, for their discussions of credit show them to be at variance only on minor matters, and these come into the foreground only when the author attempts to establish certain theories with reference to the implications of credit.

Professor Hildebrand, one of the founders of the German Historical School of Political Economy, in treat-

Where credit appears in economic development. ing of economic evolution, says that credit comes relatively late in economic development. His three periods are those of natural economy, money economy and credit economy.

In the first, people consumed what they produced; or where exchange occurred, it took the form of barter. In the second stage, money economy, exchange played an important rôle in economic life and money as a medium of exchange facilitated the selling and buying of goods. The third period of credit economy was characterized by deferred payments, loans, etc.

It cannot be maintained that each of these periods existed exclusively of the others. From the point of

view of historical development there may be an advantage in considering these periods as emphasizing a certain class of phenomena. Among primitive peoples a simple form of credit existed as soon as barter came into existence and this was a phenomenon almost as important as barter itself. From the records of all primitive peoples we have an abundance of evidence to establish this. Lending food was everywhere common. It was a common practice for those who were successful in the chase to lend game or food to those who were unsuccessful. This was treated as a loan which the borrower was to return after the next hunt. The credit was in the form of an understanding and this simple method of credit has persisted to the present. In early historical times the loaning of cattle and other domestic animals was common, and even to-day in rural communities the loaning of corn and household provisions to neighbors is a common practice.

Primitive credit.

This simple form of credit, however, has no importance in the modern system of credit. The beginnings of our present system of credit are difficult to trace. H. D. Macleod¹ maintains that "the whole system of credit, banking and bills of exchange, was originated by the Romans, and a long series of illustrious lawyers had brought the theory of credit to a state of absolute perfection: and their doctrines were embodied and declared to be law in the great code, or digest of roman law, called the Pandects, published by Justinian in the early

¹ H. D. Macleod: *Theory and Practice of Banking*, p. 159.

part of the sixth century. They were adopted and confirmed in the Basilica, the Reformed Code promulgated by the Basilian dynasty in the tenth century: and they have been the mercantile law of Europe, except England, for 1,300 years. They are fully set forth in all the great continental jurists: but, from that unfortunate aversion which the common lawyers of England so long entertained against the Civil Law, they were comparatively unknown in this country: though adopted in equity: and they have never yet found their way into any treatise on Political Economy either, foreign or English.” The same author maintains that the Roman lawyers brought the theory of credit to perfection as early as the sixth century. He furnishes us with an abundance of evidence concerning the forms and uses of credit during the first part of the mediæval period. He states that “when the practice of writing became common at Rome, it was established as a custom, or law, that every Dominus, or head of a house, should keep a family ledger as strict and exact as those of a modern banker. In this he was obliged to enter all his receipts and disbursements: all sums of money borrowed and lent: all trade profits and losses; and these family ledgers were the only legal evidence of debt among Roman citizens received in courts of justice. And it was from these family ledgers that the whole modern system of Book-keeping and Credit has been developed.”¹

In lending money, actual contracts were made by formal ledger entries in which both creditors and debtors

¹ H. D. Macleod: *Theory and Practice of Banking*, p. 163.

made entries in their respective ledgers by mutual consent. "In the year 469 A. D., the Emperor Leo abolished the strict formalities of the Stipulation, and enacted that a consent given in any form whatever, so long as the parties agreed about it, should be valid.¹ There was no necessity for any writing or any witnesses." Bills of exchange were used in foreign credit in the time of Cicero, as his writings bear ample testimony. At the time of the Roman Conquests, these were invented by Roman bankers who established correspondents abroad, and bills were given on these correspondents when Romans traveled abroad or when it was desired to meet obligations away from home. The family ledgers gradually fell into disuse and by the time of Justinian they were discontinued entirely. A documentary acknowledgment of a debt known as a cawtia and a formal contract or promise to pay, a cheirographum, had taken its place. These were transferable.

Under the Code of the XII Tables, debts could not be sold, or rather the purchaser of an account could not bring action in the name of another to collect it. However, if the debtor agreed that the creditor might transfer his right of action, it could be done. Both in Roman and in English law, creditors began to establish devices by which they could sell debts without the consent of their debtors. The Emperor Alexander Severus in 224 A. D. published a constitution²

Credit in
Rome.

The sale
of debts.

¹ H. D. Macleod: *Theory and Practice of Banking*, p. 168.

² Macleod: *Theory and Principles of Banking*, p. 208.

"by which the absolute freedom of the sale of debts without the knowledge or consent of the debtor was recognized and allowed." This practice has been recognized since as a principle of the mercantile law of Europe except in England. The earliest bills of exchange contain no statement of negotiability, yet they have been from the outset negotiable in all Europe except England.

At the present time the laws of Scotland do not require a statement of negotiability on a bill of exchange or promissory note to make it salable. This is because the common law of Scotland has adopted the general mercantile law of the continent. On the other hand, the common law of England is the early Roman law and a bill of exchange or promissory note to be salable must be drawn payable to order or to bearer. As the United States follows the common law of England, with reference to negotiable instruments, bills of exchange and promissory notes must be made out payable to order or to bearer to make them salable.

The early banking system of Greece and Rome undoubtedly gave rise to the institutions of credit and of banking in mediaeval and modern Europe.

Credit in Babylon. However, good authors claim that everything of value in banking and in credit in Greece and Rome was preceded by similar institutions in Babylon several hundred years before Christ. The early bankers of Babylon were more than changers, as they received money on deposit, paid interest for it, and loaned it for commercial enterprises.

In mediæval times, throughout Europe merchants brought their surplus products to great markets or fairs and there exchanged them for the surplus products of other countries.¹ These products were bartered, the merchants bringing with them metals which were used in settling balances. To facilitate exchange, money changers established places of business at these markets and thus made possible a money economy in place of the system of barter. By degrees the great merchants learned that it was unnecessary to bring their goods to the fairs; that instead of doing so they could send their products directly to the purchasers and secure their pay by writing bills of exchange. We have already seen that foreign bills of exchange were used to facilitate travel and to pay debts in foreign countries in the early part of the Christian era. Their use to facilitate foreign trade by introducing a means of payment for exported goods came much later. At first the bill of exchange was drawn by the money brokers and bankers who had agents abroad. By the end of the fourteenth century it had attained its present use in England.²

Influence
of credit
on the
Great
Fairs.

The essential feature of credit is the exchange of goods, services, etc., for a promise to pay in the future. In the performance of this function it is an important medium of exchange. Its great use, however, consists in its service in transferring capital. In economic treatises in recent

Medium of
exchange
function
of credit.

¹ Encyclopædia Britannica.

² See Cannonists.

years the medium of exchange function of credit has received most attention. This is due to the amount of attention that has been given to the subject of money because nations have assumed that it was necessary to adopt a policy with reference to their coinage system involving the use of two metals or one as the basis of the monetary system. Supplementing the use of money, the influence of credit in determining prices naturally received a great amount of attention.

Into the subject the influence of credit as a means of exchange, it is not our purpose to go in any detail. However, its importance warrants brief consideration. To the extent that money is an improvement over barter in effecting exchanges, to the same extent is credit an improvement on money.

Professor Johnson,¹ in treating of credit as a medium of exchange, divides it into (1) credit of general acceptability and (2) credit of limited acceptability. The former, or credit money, includes those instruments of exchange which all people of a country are willing to accept, such as the green-back, the bank note, the silver dollar and the silver certificate. They consist of those instruments of exchange whose value depends upon faith in their convertibility; that is, the belief that the government or agency which issues them, or is responsible for them, will accept them in exchange for real money. For all practical purposes these instruments of exchange are money.

The instruments of credit of limited acceptability

¹ *Money and Its Uses*, pp. 2 and 44.

have use as a medium of exchange in a restricted field. "They include the promissory note, the bill of exchange, various forms of bank credit and the book account." These instruments, the real instruments of credit, are limited in scope, but to a large extent they dispense with the need for money. All large payments of money are made by check or draft, and practically all payments due in foreign countries are made by foreign bills or drafts. The great bulk of the exchanges of a country is effected by these means. The industrial prosperity of the country would be greatly retarded if it were not for these instruments for effecting exchanges.

The extent to which these instruments are in use in the various countries as a medium of exchange depends somewhat on the habits of the people, the degree of confidence which business men have in each other, and also the condition of prosperity. On the continent of Europe people are much less inclined to pay bills by writing checks against deposits in banking institutions than English and American people are. This is due to their conservative habits. In prosperous times people use credit instruments to a much greater extent than in periods of depression or of inactivity. Relatively speaking, where free use is made of credit instruments as a means of exchange, but little use is made of money, and where but little use is made of credit instruments, money must be freely used.

The area over which credit instruments are used as a

What
governs
the extent
to which
credit in-
struments
are used.

means of exchange is limited by the area over which business men have confidence in each other. Consequently the larger the area of business confidence the greater will be the resort to credit instruments for this purpose.

As has been stated, the great function of credit is to promote the production of wealth and to facilitate the exchange of capital. It consists in the ex-

The chief functions of credit. change of commodities, money or services, for a promise to pay in the future. The

various producing industries—mining, manufacturing, agriculture, mercantile and transporting—must secure raw materials, machinery and other instruments of production as well as funds for building and other purposes. This is advanced at the outset by investors as capital credit, and later the various institutions engaged in production find it necessary to secure funds, usually from banking institutions, in exchange for their promise to pay. Public credit is also to an increasing extent used to secure funds for productive purposes.

The use of credit funds for exchange and production purposes may be seen from the following illustrations

Use of credit illustrated. from the manufacturing industry. The manufacturer engaged in the production of machines has not sufficient capital, raw materials, machinery and funds to employ laborers to carry on the productive process until his products, the machines, are sold. He goes to the producer of raw materials and asks him to exchange the raw materials

for a promise to pay at a time usually when his products are sold. If his credit is good, he secures the raw material and gives in exchange his promise to pay a sum which is somewhat more than the present value of the raw materials. This amount, known as interest, which is greater than the present value of the goods sold, is to compensate the seller for waiting for his money, and is a large or small amount as the risk of not being paid is great or small.

To carry on the productive process it is necessary to employ many workers who labor for wages which are usually paid weekly or who labor for salaries which are usually paid monthly. If the manufacturer has good credit the wage earners will advance their services throughout the week for a promise to pay at the close of the week; and those who work for salaries will advance their services during the month for the promise to pay at the close of the month. The contracts for these credit transactions may be written, but in the great majority of cases they are oral but are none the less binding on that account.

The same manufacturer must secure an advancement of money or funds from banking institutions because he must pay his labor before he can realize on the goods they are producing and often because in selling his goods he must wait several months before he can secure his pay for them. The banker whose function is to deal in credit, advances money or the right to draw funds at any time in exchange for the promise of the manufacturer to pay in the future.

**Essential character-
istic of credit.** Professor Laughlin¹ is right in insisting that if "an essential function of capital is to discount the future, the essential characteristic of credit is the element in it of futurity." Any transaction which does not involve the promise or the obligation to pay in the future is not a credit transaction. A barter or a cash sale in which the transaction is closed, is just the opposite of a credit transaction which calls for payment in the future.

Confidence as a basis of loans. There ought to be no reason for a quarrel between Professor Laughlin in claiming that the essential thing in credit is futurity and those who insist on the importance of confidence in credit. Each plays an important although a distinct rôle. Futurity is the distinctive factor in credit itself, while confidence lies at the basis of the granting of credit. Professor Laughlin himself makes this distinction, but unfortunately in the minds of his critics he assigns to confidence a subordinate rôle. In mercantile credit confidence is especially important. The seller of goods accepts the promise of an individual without means to pay only (1) when he has confidence in his ability to pay and (2) when he has confidence in his willingness to pay in the future. These two factors are important in all mercantile loans. A commercial loan is not based on goods as many suppose. The goods advanced are offered for sale by the purchaser and the original seller has no specific claim on them or on the proceeds of their sale only in exceptional

¹ Laughlin: *The Principles of Money*, p. 73.

cases. Confidence in willingness and in ability to pay are the foundations of all mercantile credit. In bank loans where collateral is demanded and in all mortgage loans, the situation is different. In these cases, the one who accepts a promise to pay receives with it securities which insure payment when the debt is due. However, bank loans based on collateral are decreasing in importance as contrasted with loans made to corporations and business houses based on their credit standing and their ability to pay their debts.

The dispute as to whether credit is based on money or goods, whether it is a demand for money or for goods is not important for our purposes here. A description of the relation between credit and money and credit and goods will suffice. As has been stated a credit transaction is the exchange of goods or services for a promise to pay in the future. The promise to pay is usually expressed in terms of money. This credit transaction is also usually completed by the payment of money, credit money or a title to money. When a bank borrows money for thirty or sixty days time, it may cancel the debt by paying gold, credit money, or by a book credit, giving the lender the right to draw money. However the debt may be paid, the contract in the United States calls for its payment in dollars of 23.22 grains of pure gold, and the lender may demand payment in gold if he chooses to do so. So far as the credit transaction is concerned, there can be no question that the contract calls for payment in money.

Relation
between
credit,
money,
and goods.

All convertible or credit money is a demand for money, and it gives its possessor the title to this money—which is a commodity and has real value. Of course the purpose in securing money is not on account of any satisfaction which money may give, but because of the goods it will buy. When a merchant or manufacturer sells goods and accepts a promise to pay money, what he desires ultimately is not money, but production or consumption goods. The same is true of the laborer who works for wages and all others who contribute something to the productive process. What they want is not money but what money will buy, the necessities and luxuries of life and the means of production.

The contention that credit is based on goods and is limited to the amount of goods in existence is not wholly correct. In the case of a mercantile loan, the sale of goods on time, it will be seen later how funds may be advanced to several times the value of the goods. In mortgage loans and loans based on the deposit of collateral, the loan is definitely limited by the quantity of property or wealth the borrower has. In most cases, however, the loans are based not only upon the quantity of property the borrower has, but upon the lender's confidence in his integrity and in his ability to produce. As Professor Johnson puts it, "Credit is limited, therefore, not by a community's wealth, but by that plus lenders' estimates of its power to produce wealth."¹

Although credit makes possible an increase in the

¹ Johnson: *Money and Currency*, p. 38.

production of wealth and facilitates the utilization of capital, it is neither wealth nor capital. Much misunderstanding exists among competent authors on this point through a failure to appreciate the real significance of economic terms, especially wealth and capital.

Credit not
wealth or
capital.

Wealth consists of economic goods. Capital goods consist of the economic goods used in the production of wealth. Credit which has been defined as "the power to secure commodities or services at the present time in exchange for some equivalent promised at a future time" is no more wealth or capital than is labor power or organizing ability. Labor power contributes greatly to the wealth and capital of a country but it is not for that reason capital. Organizing ability also increases wealth and capital but it is not for that reason either wealth or capital. The division of labor has been one of the greatest factors in the increase of the wealth of society, but the division of labor is never thought of as wealth or capital. The credit transaction which consists of an exchange of goods or services for a promise to pay does not increase the sum total of economic goods. It simply means an exchange of possessors. Although many credit instruments may be exchanged, the actual means of satisfying wants have not been increased by the process.

We may admit the statement of Daniel Webster that "credit has done more a thousand times, to enrich nations than all the mines of all the world," without conceding that it is either wealth or capital. What then is the

function of credit? As Levasseur puts it, "Admit in summing up this analysis, that credit strictly speaking, creates nothing, that it is simply a displacement of capital; nevertheless in transporting capital to a place where it can be employed most profitably, in furnishing tools to labor, in rendering active that which was inactive, and fertilizing that which was sterile, this simple displacement introduces a profound modification into the economy of society, it renders production more active and increases wealth."¹

¹ *Elements of Political Economy*, p. 208. Translated by T. Marburg.

CHAPTER II

CREDIT INSTRUMENTS

A CREDIT transaction is one in which something of value is exchanged for an obligation to pay in the future. A credit instrument is the evidence of this obligation. It may be exchanged for economic goods in which case it constitutes a demand on the part of its possessor for the payment of the obligation at maturity or, like the book account, it may be simply a record of the contractual relations between debtors and creditors. One writer prefers the use of "instrumentalities rather than instruments, to cover cases of orders and promises by telegram and telephone."¹

Credit instruments may be divided into (1) promises to pay and (2) orders to pay. The chief promises to pay are promissory notes, bank notes, deposits, book accounts, stock certificates, bonds, etc., and the chief orders to pay are drafts, bills of exchange, checks, circular letters of credit, post-office orders, mobilizing certificates of all kinds such as warehouse receipts, bills of lading, etc.

A promissory note is a written promise to pay a certain sum of money at a future time under definite conditions. Promissory notes are frequently exchanged for goods or funds. They are among the most com-

Defini-
tions.

Two
classes of
credit
instru-
ments.

¹ Andrews: *Institutes of Economics*, p. 143.

mon of credit instruments. A man whose credit is good may exchange his promise to pay in the form of a

The promissory note. promissory note for goods, or for money or other funds. They are made either negotiable or non-negotiable. If the note is made

payable to a particular person without order or bearer on the note, it is non-negotiable. If it is made payable to order or to bearer, it is negotiable. The negotiable promissory notes are the most common form of note credit instruments. They are used freely in the payment of debts, and consequently may be transferred a great many times, and on this account perform all the functions of money. When sold, they must be endorsed by the person to whom the note is ordered to be paid. The endorsement may be either in blank or special. The former specifies no indorsee and an instrument so indorsed is payable to bearer and may be sold on delivery. A special indorsement indicates the person to whom or to whose order the note is to be paid, and must be endorsed by such person before it can be sold again.

Use of the promissory note. The promissory note was used early in the history of credit transactions. It is now the most common instrument used for the transfer of funds. In the United States prior to the Civil War when goods were sold on time, except by retailers, the promissory note was almost invariably used. Even since the Civil War it has been used for this purpose more than any other instrument of credit. On account of its ease of negotiability it serves this

purpose well as it often passes through many hands before it is finally paid.

A bank note is a bank's promise to pay the bearer the amount specified on its face. As it is intended to pass freely from hand to hand, it is a credit instrument of general acceptability. The freedom with which it circulates at its face value depends upon the general credit standing of the banking institution or upon special provisions made for the redemption of the note circulation of banks. It is well known that the note issues of private and state banks in the United States before the Civil War fluctuated greatly in value, while the national bank notes issued in accordance with the National Banking Act of 1863 are absolutely safe owing to the use of United States bonds pledged to their redemption. In other countries as Canada where bank asset currency prevails, bank assets may be used in such a way as to make bank notes practically safe.

A bank deposit imposes on a banking institution the same obligation as the bank note. Both are promises of the bank to pay on demand. In the case of bank deposits, the only record which depositors have of the obligations of the bank, is in the books of the bank and in the pass book in possession of the depositor, which contains a copy of the bank-book record. The depositor in this case exchanges funds for the promise of the bank to pay on demand, in which case the credit instrument is a book account which the bank keeps. For purposes of collection this account

The bank
note.

The book
account.

or credit instrument is as valuable as any that are recorded.

In the use of the book account as an evidence of debt one person may exchange money and other property for a credit upon books. That is a right of action on the part of one who exchanges something valuable is secured against the individual who receives it. Common cases of book accounts are those used by the retailer when he sells goods to a consumer, or by a banking institution in making a record of deposits. In the former case, the retailer exchanges goods for a promise to pay, which evidence is on the books of the retail institution. This record of the debt gives the retailer a right of action against the receiver of goods for the value of the goods as indicated by the books. The book account is as valuable a credit instrument as any that is used. It does not, however, serve the purpose as a medium of exchange or serve the purpose of paying many obligations the same as checks or other credit instruments to be considered later. However, the book account may be sold and the purchaser of the book account has the same right of action against the debtor as the original creditor had. When a retail business is sold, the book accounts are usually a part of the sale. Book accounts may also be sold outright to any one who wishes to make the purchase and who will take the responsibility of collecting debts.

The book account is perhaps the oldest of credit instruments. Some primitive peoples kept records of things loaned. We have already seen how the family

ledger was used in ancient Rome to record credit relations and these credit transactions which were recorded in the register were legally binding.

Book accounts are kept as customary the only evidence of debt by professional men as lawyers, doctors, etc., and by manufacturers, builders, contractors, etc. These accounts have a legal status and are salable.

A modern use¹ of the book account in banking transactions in lending on open book accounts has developed in recent years as a result of changes in trade organization. When the commission merchant was a powerful factor in trade he performed the function of banker as well as merchant in that he often advanced funds to the mill owner, to the planter or to both of them. Since his disappearance, there has arisen a banker who now conducts the financial part of the commission merchant's business in advancing funds to reliable traders or manufacturers on open book accounts. The trader who has borrowed from his banker all that his means and credit standing will permit sometimes finds himself handicapped in trade when he cannot pay cash for the goods he buys. This new type of banker requests such a person to furnish him the names of the firms from whom he wishes to buy. When their ratings are found to be satisfactory, an indemnity bond is secured covering the goods in question. The invoice of the seller must contain a notice that payment for the goods should be made to the banker. When

Uses of
book ac-
counts.

A new
type of
loans.

¹ *The Journal of Accountancy*, Feb., 1912, pp. 127-132.

a notice is received to the effect that an order for the goods has been filled the shipper is sent an amount not exceeding 80 per cent. of the value of the goods, and this is charged to the account of the purchaser. When payment is received the banking concern deducts the interest on the amount advanced, charges a fee for its services, and pays the seller the amount still due him. A method similar to this is sometimes used in advancing funds to importers of foreign goods.

"A share of stock is a certificate of ownership in a corporation."¹ The stockholders are the owners of the

Stock certificates. property of the company. However, a credit relation exists between the stockholders and their corporation. In purchasing stock the

stockholders exchange funds for stock certificates, which are credit instruments that indicate the number of shares of the company to which the holder is entitled. While the stock certificates themselves are not negotiable, for all practical purposes they are. The registered holder of them may sell them and deliver them to the buyer with his assignment in blank, and in this way they may pass through a great many hands without any registration on the books of the corporation. Stocks are used extensively as collateral for bank loans, and the more fully negotiable they are the better they are for this purpose; consequently the tendency is to make them more easily transferable.

The two main classes of stocks are the preferred and the common shares. The preferred stockholders are

¹ Meade: *Trust Finance*, p. 150.

given a preferred claim to the profits of the company and in event of dissolution of the corporation they are usually given a preferred claim to the assets of the company. The preferred stockholders are usually paid an assured dividend which must be paid before the common stockholders receive any dividends at all. The common stockholders, upon the other hand, frequently have the exclusive management of the business of the corporation, and while they receive what is left of the profits of the company after the preferred stockholders and in some cases the bondholders are paid, if the business is a very successful one they receive comparatively large profits.

Preferred
and com-
mon
stock.

The leading stock investments are in public service corporations and in industrial companies. As corporate organization in these enterprises has increased vastly the last fifty years property in the various classes of stocks has also increased to vast proportions.

What is said of the increase of stocks as credit instruments may also be said of bonds in industrial and public service securities. However, bonds are more extensive than stocks, as they include also loans to governments, national, state, and local. Like the stock certificate the bond is ordinarily negotiable and as it too is used as collateral to secure loans there is every reason to facilitate its negotiability. A bond is a promissory note in which a government, a corporation, or in exceptional cases, an individual promises to pay a certain sum of money. A bond differs from an ordinary promissory note in that "it is issued as a part

Bonds.

of a series of like tenor and amount, and in most cases under a common security.”¹ The security for a bond, like that of a note, may be found written upon the face or back of the bond itself.²

Corporate bonds are different from corporate stocks as the bond holder is a lender to the corporation who is

Corporate bonds. promised a definite sum of money at a specified time at a certain rate of interest and ordinarily he has nothing to do with the management of the company. The bondholder usually has some kind of property pledged to the payment of the note while there is no pledge of property to pay the holder of stock.

The different kinds of bonds, classified with respect to their security, are numerous, including such as real

Kinds of bonds. estate bonds, general mortgage bonds, blanket mortgage bonds, equipment bonds, debenture bonds, etc.

The name of the bond indicates the character of the security offered, but it is not within the province of this treatise to go farther into the subject of the security offered.

Of the credit instruments which are orders to pay, the check has come to be the most important in the

Checks. United States. It is an instrument authorizing the transfer of funds which are credited to the maker of the instrument. It is a written order by an individual who has a deposit in a bank upon the banking institution to pay a certain sum of money.

Checks are sight bills on bankers. The check when pay-

¹ Cleveland: *Funds and Their Uses*, p. 169.

² Cleveland: *Funds and Their Uses*, p. 169.

able to bearer or to order is a negotiable instrument and the individual who receives it, upon endorsing it, may transfer it to some one else in payment of an obligation. The check may circulate very freely in the business community, and it may cancel many obligations the same as money can. It is used in the payment of obligations both locally and at a distance, and to the extent that it is used, it dispenses with the need of money.

Records from Babylonian history¹ show the existence of deposit banking in Babylonia. At first depositors left their money with large money lenders for which they accepted receipts. Against these funds depositors wrote checks ordering the bankers to pay money to creditors of depositors. We see that the beginning of the check system thus dates back to early Babylonian history. The deposit system was established in Sicily in the fourteenth century and depositors were given the privilege of ordering by check payment of sums of money to others.

Use of
checks in
early
times.

In the United States and Great Britain the greater share of cash payments are made by checks. In other commercial countries the tendency to pay large sums of money by checks rather than by cash is rapidly increasing. Bills and notes are used for time transactions while checks are used for cash payments. The latter are superior to bills as they may be used in making payments promptly and consequently afford a faster method of doing business.

Use of
checks at
present.

¹ Aldrich: *Money and Credit*, p. 72.

Checks are usually presented, not where the deposit is, but in the holder's bank, and a completely developed clearing house system enables the banks in a commercial community to settle their claims against each other without delay.

Closely associated with the common check are the certified check, the cashier's check, the cheque bank **Kinds of checks.** check, the letter of credit, the traveler's check and the post-office money order. They are all practically orders to pay funds which the drawer has deposited, or to which he is entitled.

It sometimes happens that a depositor will desire to make payments where he is not known and where the payee does not care to take chances on a private check. Two devices are open to him: (1) He may draw his check for the amount desired, have the cashier of the bank where his deposits are write above his signature across the face of the check "certified" or "good when properly endorsed." This certified check is acceptable to the payee because its payment is guaranteed by the bank. (2) The second method is to exchange his check for the "cashier's check" made payable to the person designated by the depositor.

An institution known as a "Cheque Bank" sells to its customers a book of its checks made up of assorted **The cheque bank.** blanks, and across the face of each is written the maximum amount for which each may be drawn. The buyer pays the sum of the amounts written on each check and when the book is returned, the bank refunds the difference between

the amount paid for the cheque book and the amounts paid out. The purpose of the cheque bank is to make its checks more acceptable than the common check.

A similar method of transferring funds also for the benefit primarily of travelers is the travelers' check issued by express companies. The best known of these are the American Express Company's checks. The purchaser secures from an office of the American Express Company a number of checks of various denominations to suit the convenience of the traveler. They are bound together so that they may be carried conveniently and, as the agents who are authorized to pay these checks are widely distributed, the holder of these checks finds them very convenient as he can have them redeemed by banks, hotels, business houses, etc.

The letter of credit is intended primarily for the convenience of those who travel in a foreign country to enable them to collect funds where they are unknown. The purchaser of the letter of credit secures the right to draw sums of money at different times not to exceed the face value of the letter, while the letter of credit is a guaranteed account by the bank issuing it. When funds are drawn where the letter of credit is presented, the bank official writes down the amount drawn on the letter and he requires the customer to write his name and this signature is compared with the signature of the holder at the time the letter of credit was purchased. Letters of credit are of great convenience to the traveling public as advancements may be secured

The
traveler's
check.

Letters of
credit.

nearly everywhere and no identification is necessary aside from the comparison of signatures.

The post-office money order is an instrument widely used in America for transferring funds. It performs practically the same function in transferring **Post office money order.** money as checks and banks drafts. One who desires money sent to some one at a distance

may go to the nearest post-office station, purchase a money order for the amount desired, which is made payable to the person specified. It is then sent by mail to the payee who presents it at his post office and receives the amount designated.

A bank draft is a bank's check upon any banking institution in which it has a deposit or credit relations **The bank draft.** to pay a certain sum of money. It is an instrument used by a bank to draw funds from another bank in which it has deposits the same as a check is an instrument by which a depositor draws funds from a bank where he has deposited money. The person receiving the draft, the payee, may upon endorsing it sell it to some one else and it may serve as a medium of exchange, passing through a great many hands. The bank draft is used to pay debts at a distance, to transfer money to remote sections of a country or to a foreign country, and also to facilitate travel by transferring money with but little risk to places where it is made available.

The bank draft was the earliest Bill of Exchange. Bank drafts were dealt in extensively in Greek and Roman times. The money changers or bankers had

branches or agents in distant cities and foreign countries upon whom they drew for the payment of money. By selling drafts they enabled merchants to pay debts incurred in purchasing merchandise at a distance. In selling drafts to travelers they enabled the latter to go to distant countries, obtain the money of the country and travel with ease.

A bill of exchange or commercial draft is an order or request by one person upon another to pay a certain sum of money. The payee may be the drawer of the bill or some one that the drawer owes. A bill of
exchange. In either case the amount paid is charged to the account of the drawer. The occasion which gives rise to a commercial draft is usually a sale of goods. The seller of merchandise makes out an order against the purchaser to pay the purchase price of the goods either to himself or to some one else who is to collect the bill. The bill may be made out payable at sight or after sight. The former is known as a sight draft. If the seller of the merchandise desires to give credit to the purchaser for a few months, the bill of exchange is made out payable after the lapse of the credit period. The bill may be accepted by the purchaser of the goods writing across the face of the instrument "accepted" with the date of acceptance and signing it.

The bill may then be sold to a banking institution or any one else who will make the purchase and both the drawer and drawee become responsible for its payment. As a salable instrument it is double-name paper. Its acceptance makes it a written evidence of debt the

same as a promissory note. Without being accepted a bill is not a credit instrument. It is simply a request of one person upon another to pay a sum of money. However, bills not accepted are frequently sold as responsibility for them rests with the drawer.

In England¹ a distinction is made between a bill of exchange and a draft. Only bills that are "accepted" are drafts. All others are bills of exchange. Bills of exchange often mean foreign bills, while acceptances are domestic or inland bills. However, bills of exchange are ordinarily included to cover both "accepted" bills and those not accepted and foreign bills and domestic or inland bills.

The commercial draft grew out of the Great Mediæval Fairs of Europe which were centers for the distribution of products. After the period of direct barter, money changers attended the fairs to exchange money for the traders. With the great multiplication of goods to be exchanged and a better organization of the mercantile system, merchants remained at home, shipped their goods to each other, and by means of bills of exchange they secured payment for their goods with the use of but little money.

Bills of exchange have reached the greatest degree of acceptability in England. Where in America the promissory note is generally used pledging the promise of the purchaser to the payment for a bill of goods sold on time, in England the commercial draft is used. Often to these

¹ *Journal of Accountancy*, Dec., 1911, p. 601.

drafts bills of lading are attached representing the property shipped, which is a pledge to the payment of the bill. As each succeeding endorser is pledged to pay the face of the bill they may pass through many hands and are considered relatively safe instruments of credit.

The bill of exchange is also used in what is termed accommodation paper. *A* may order *B* to pay a certain sum of money and when *B* accepts it, *A* may sell it to a banking institution. *B* in turn orders *A* to pay a certain sum of money and as soon as *A* accepts it, *B* can dispose of it to a banking institution. This is known as accommodation paper. Other forms of bills of exchange are not subjects for discussion here. The two sorts of transactions, however, represent the purposes for which bills of exchange are made out.

Aside from the promises to pay and the orders to pay other credit instruments are bills of lading and warehouse receipts.

The bill of lading is an itemized statement of goods shipped, and it gives the purchaser or the one to whom the goods are shipped, a right to them. The bill of lading is both a receipt and a contract. It is a receipt given by the transportation company acknowledging the acceptance of goods and it is also a contract between the transportation company and the shipper stipulating the terms and manner of shipment and the carrier's responsibility. As the bill of lading is a right to certain specified goods, it is a saleable credit instrument and may be transferred frequently, and as often as it is sold, the goods called for by the bill

Bill of
lading.

of lading change hands. As it is a favorite collateral for loans from banks, it is not only used to facilitate the sale of goods but as a basis of credit pending their sale.

The bill of lading is often an instrument used in the collection of accounts. In shipping a bill of goods the seller often attaches a commercial draft to the bill of lading with the understanding that the latter is to be delivered, together with the right to the goods only when the draft is paid.

The bill of lading is used as collateral to secure the advancement of funds especially in cases of standardized

products such as wheat, cotton, coffee, etc.

**Uses of
the bill of
lading.** Local buyers of grain are without much capital and to do an extensive business they must

secure advancements of funds from commission men who buy from them, or from their local banks. A favored way of securing advancements when grain is shipped, is to attach to a bill of lading a draft written against the commission man and deposit them with the local banker who will advance funds which are used in buying more grain. When grain is again shipped from the interior market to the seaboard, the shipper secures a bill of lading from the vessel or railway company, draws a draft against the consignee and deposits the draft and bill of lading with the bank and has funds advanced. The cycle of transactions of this class is completed when the exporter draws a draft against the foreign purchaser and attaches to it the steamship bill of lading and the insurance policy on the cargo and takes them to his banker and sells the bill.

The warehouse receipt performs practically the same function as an instrument of exchange and as a credit instrument to secure the advancement of funds, as the bill of lading. It is a receipt for goods classified and placed in a warehouse. The purchaser of many classes of farm products exchanges funds for a warehouse receipt which entitles him to the possession of the goods deposited. Goods are sold through a disposition of the warehouse receipt. When sold the warehouse receipt must be endorsed the same as a promissory note, check, or other instrument of credit. It is also used frequently as collateral for the advancement of funds. With the increased tendency to classify and to standardize warehouse products, it becomes to a greater extent both a negotiable instrument and collateral for the advancement of funds.

Ware-
house
receipt.

Contracts for the delivery of grain are usually fulfilled by a tender of warehouse receipts.¹ "The receipt states the name of the elevator company issuing it, the date of issue, the kind and amount of grain, and the name of the owner." When sold the receipts are endorsed.

Terminal elevator companies buy large quantities of grains and to carry on their buying operations they are heavy borrowers of banks. To procure loans elevator receipts are deposited as collateral. They are considered safe collateral and where the market is stable bankers advance

Use of
warehouse
receipts.

¹ "American Produce Markets," Annals of American Academy of Political and Social Science, p. 39.

funds to 90 per cent. of the value of the receipts. When the grain is sold the loans are paid and the receipts are surrendered. All others engaged in purchasing grain secure the advancement of funds from banks by depositing warehouse receipts with them.

CHAPTER III

KINDS OF CREDIT

DEPENDING upon the basis of classification credit may be classified in a variety of ways, and each class may be divided into many sub-heads. We may group all classes of credit under two main heads, public and private credit. From the point of view of the use of funds credit may be divided into productive and consumptive credit and to these may be added a third, public credit, which is in part productive and in part consumptive credit. Upon the basis of the personality of the borrower credit may be divided into individual credit and corporate credit. In the above suggested classification each of the main divisions of credit may be divided into many subheads.

Basis of
classifica-
tion.

Upon the basis of the conditions affecting credit, credit may be divided into five kinds:¹ mercantile, personal, banking, public and investment credit. This classification will be used in the present treatise. While no hard and fast lines can be established between different kinds of credit, it is believed that this classification

¹ Prendergast divides credit into the same five classes [Prendergast: *Credit and Its Uses*.] Galloway divides credit into four classes, Personal, Mercantile, Business and Banking Credit. [See *Advertising, Selling and Credits* in the "Modern Business Series."]

serves a useful end in describing the uses and purposes of credit. This chapter represents an attempt to describe the last three classes and to explain their relation to mercantile credit, while a discussion of personal and mercantile credit is reserved for subsequent chapters.

Mercantile credit is the power to secure goods for purposes of sale in return for an equivalent promised in the future, and a mercantile credit transaction consists of an exchange of goods for a promised equivalent. A sale of goods on time is a mercantile loan. Wholesalers, jobbers, commission men and retailers deal in mercantile credit, as sellers are frequently compelled by business practice to give time for the payment of goods from the proceeds of their sale.

Personal or individual credit is the power to secure something valuable in the present in exchange for something promised in the future. It is sometimes known as consumptive credit, as personal credit is obtained at present chiefly for purposes of consumption, but in this discussion personal credit not only includes consumptive credit but also the credit which enables individuals and partnerships to secure capital for purposes of production.

BANKING CREDIT

Banking credit is the power of a banking institution to obtain something of value in the present in exchange for its promise to pay. In the case of a simple de-

posit the bank exchanges its promise to pay in the form of a certificate of deposit or a book credit for funds or a title to funds. Because the bank is required to pay money in the future, this transaction is often termed a "short sale" of money. In other instances which arise in the ordinary work of Commercial Banks, the bank exchanges its credit for the credit of persons or associations.

Banking
credit
defined.

The three primary functions of a bank are those of deposit, discount or loan, and note issue. The early bankers were money changers, who exchanged one form of money for another either domestic or foreign. Perhaps the next function assumed by banks after money changing, was to pay a given amount to some one else in another place.¹ To do this work, it was necessary to have correspondents in other places on whom orders to pay were drawn. This function was assumed by bankers in Babylonia, Greece and Rome. The next step toward the modern banking system consisted in receiving deposits for which receipts were given, the depositor being permitted to withdraw his funds upon presentation of his receipt. He was also permitted to order his banker to pay to a third person all or a part of the amount deposited. This method of banking was prevalent in Babylonia as well as in the mediæval states of Europe. A transfer of funds from the credit of one person to another on the books of the bank was permitted by the leading banking institutions of mediæval Europe. At

Banking
functions
in early
times.

¹ Seligman: *Principles of Economics*, p. 525.

first the transfer could be made only by word of mouth in the presence of both parties but later the transfers were made by written order or draft by the depositor upon the banking institution.

The loaning of funds deposited with banks for purposes of safe keeping was at first considered incompatible

Functions of modern banks. with the proper custodial care of people's funds. However, the functions of money lending and deposit banking became common

in Greece and Rome as well as in Mediæval Europe. The bank of Amsterdam was perhaps the first to advance money upon deposits of coin or bullion, the latter to be given to the owner upon the return of the money advanced. By degrees advancements were made upon the deposit of other things, the funds or wealth deposited guaranteeing the return of money advanced by the bank. As an outgrowth of this development we have to-day such specialized institutions as the agricultural and mortgage banks of Europe, and the bond and mortgage companies and other closely related institutions of the United States. The acceptance of collateral by commercial banks to guarantee the payment of loans is a modern safeguard corresponding to the advancement of money based upon deposits of bullion of the mediæval bank.

The conditions under which banks lend do not come directly under the head of banking credit, or the power of banks to secure advances of funds in exchange for their promises to pay. But as the power of banks to command the

Foundations of banking credit.

confidence of the business community, and also the funds of the community, depends almost entirely upon the caution and judgment of banks in lending their funds, it seems appropriate to consider the conditions under which banks lend their credit.

As contrasted with the earlier banking institutions, credit creation is the distinctive feature of the modern banks. The bank loans not alone its money but its credit. In the regular routine of bank-
Credit
creation.
ing in the great majority of cases when a loan is made, cash is not paid out to the borrower, but he is given a credit account on the books of the bank. Likewise, when the loan is paid, the banker simply charges the amount against the borrower's account. In our modern methods of business but little cash is used, the great bulk of payments being made in checks or drafts against an account in a bank. Because of this, when business men borrow from a bank they do not want cash but a deposit account which they can draw on by checks when they make their payments. Business men thus leave nearly all their funds with banks because it is to their interest to do so. Since banks enjoy the confidence of the business community to such an extent as to retain as deposits in large measure the funds loaned as well as other deposits left with the bank, it can loan to a far greater extent than its capital and deposits combined. It is by this method of credit creation that the bank earns its chief income and performs its greatest social service. Experience shows that not all who have claims against a bank will present them at once, and that

in ordinary times, a bank needs to keep but one-fourth or one-fifth of its obligations in its vaults for redemption purposes. This means that by use of its credit with a given amount of funds a bank can lend several times as much as any individual.

Mercantile credit and banking credit are mutually dependent. Mercantile credit transactions give rise to

Relation between mercantile and banking credit. the great bulk of banking credit and banking credit supports and makes possible mercantile credit. When goods are sold by manufacturers, jobbers or other middlemen on thirty, sixty, or ninety days time, the seller usually accepts a promissory note from the buyer as a pledge of payment, or, as is the usual case in the British Isles, he writes a bill or draft ordering payment which the buyer accepts. These notes or drafts are taken to the commercial bank and discounted. In other words, these promises to pay, the evidences of the mercantile loan, are sold to the commercial bank, the latter advancing the funds, or in other words, making a loan to middle men to cover the value of the goods sold. The loan function of the bank is ordinarily called the "discount function" as the great majority of its loans are made by discounting notes, drafts, or other paper which come into being in the ordinary course of business of which the above is typical. It is obvious that the mercantile loan gives rise to a large volume of banking loans. However, if it were not for bank loans, mercantile loans would be greatly restricted. Time is given frequently by the manufacturer, jobber, etc., because they know that

they can take the notes of the buyer to the commercial bank and have them discounted. The great majority of mercantile houses have not an adequate supply of capital to carry on an extensive loan business without the aid of banking institutions, and it was for the purpose of rendering this and similar functions that the modern commercial bank was developed. Mercantile credit is thus fostered and supported by banking credit.

When the merchant sells to a bank the promissory note of the purchaser of his goods endorsed by himself, the banker subtracts from the face of the note the interest for the time the note is to run, and either gives the merchant the present value of the note in money, or gives him credit for the amount on the books of the bank. Where money is paid, the bank exchanges a present value for the promise to pay in the future. This transaction involves banking credit only in the sense that the bank is a giver of credit. In the other case, where the merchant is given credit on the books of the bank for the amount due him, banking credit is exchanged for mercantile credit. The bank exchanges its promise to pay for the credit instrument which the purchaser of goods gave to the seller.

Individual or personal credit is related to banking credit in a similar way. Individuals who enjoy a good credit reputation may borrow money from a bank. If the bank pays the money directly to the borrower in exchange for his promissory note, banking credit is involved in the transaction only in the sense that the bank is

Relation
of banking
credit to
personal
credit.

a giver of credit. Upon the other hand, if the borrower of the money leaves it on deposit in the bank, which is the usual case, then the bank exchanges its promise to pay for the promise to pay of the borrower, in which case banking credit is exchanged for personal credit.

In some respects banking credit is the highest form of credit, for the standards set by banking institutions

Banking credit sets standards. are, and should be, above those of any other individual or institution giving credit. In the very nature of things, a bank should enjoy the fullest confidence of the public.

If it does not, its service is at an end. As it has custodial care of the funds of the community, the people desire to be certain of getting their money when they want it, or when the obligation of the bank to pay them, matures. When a merchant buys a bill of goods on sixty days' time, if he is unable to pay the note when due he may ask for an extension of time, which the seller may be willing to grant or be compelled to grant for practical reasons. In personal credit too, borrowers may be unable to pay notes when due and their requests for an extension of time are frequently granted. But a banking institution cannot ask for extensions of credit; it must meet its obligations as they mature or close its doors and admit its failure as an institution of credit.

Since a bank makes its chief income by loaning its credit, and as its loans are usually several times in excess of the funds in the bank to redeem them, and furthermore, as it must close its doors the moment it confesses its inability to meet its obligations, it is imperative that

it should exercise the greatest caution in lending. It is limited to short-time loans, that is, call loans, and loans for thirty, sixty, and ninety days. Where loans are made to persons, most banks limit their purchases to "double name" and "triple name" paper. When "single name" paper is purchased, the borrower must be a man of ready means who is certain to have funds ready as his note matures. Where a loan is based on a sale of goods, the paper purchased is almost invariably "double name" paper, as the purchaser gives his note to the seller and the latter, before selling it to a bank, must endorse it.

Accommodation paper is also "double name" paper. In this case would-be borrowers exchange their notes or bills, take them to their respective banks, affix their own signatures, and banks buy them as "double name" paper. Much has been said of the inferiority of such loans as contrasted with those based upon a sale of goods. While the latter class of loans is superior to the former, its superiority has been greatly exaggerated. Since the sale of goods gave rise to the loan, and although the maker of the note is supposed to pay it from the sale of the goods, and often does so, no property is pledged for the payment of the note and, as will hereafter be shown, several notes are often written based upon the sale of one lot of goods. Loans made for consumption purposes, as is often the case, clothe the borrower with no power whatever to pay them when due. In either case, however, much depends upon the ability of the bor-

Accom-
modation
paper.

rowers to pay their debts and upon the habits of the borrowers in debt payment.

Often the deposit of collateral consisting of shares of stock or bonds is required as a pledge of payment of notes. The safest collateral accepted is **Loans on collateral.** that which is quoted on the Exchange as it may be sold at once and the loans paid.

Commercial banks often have regular credit departments to pass judgment on the value of titles to property submitted as pledges to loans, and also **Credit departments.** to pass judgment on the worthiness of borrowers. Business houses are often granted lines of credit which permit them to borrow from the bank up to a certain limit. These lines of credit are granted after a thorough investigation of the credit standing of houses seeking credit.

The interest charged by banks is relatively low, as the terms are for short periods and as great caution is exercised to avoid risks. This means also **Interest rates.** that banks give very low rates for the money they borrow.

PUBLIC CREDIT

Public credit has no immediate relation to mercantile credit, and only a brief consideration will be given to it. It is the power of government—**Public credit described.** national, state, or lesser political division—to secure funds in exchange for its promise to pay in the future. Its chief instrument of credit is a

government bond, which is a promissory note of the government sold to purchasers; or, in other words, it is exchanged by the government for funds advanced by individuals. In some instances a special class of property, or the income from specified property, is pledged to pay the loan, while in other cases the lender depends exclusively on the faith of the government to pay the obligation. These loans are the typical long-time loans, and the interest rates are low where the governments are stable. Where governments are insecure, the interest rates are higher, varying with the insecurity of the government.

Another type of the public debt is the floating loan, which is frequently a forced loan. In time of war, when armies are in the field, it is often necessary to secure loans of provisions and equipment from the section of the country over which the army passes. Certificates of indebtedness are issued by army officials which are exchanged for these things, and are usually redeemed at the close of the war.

Floating
loans.

At times governments resort to their promissory notes, or government paper money, which are given general circulation when governments pay their obligations. These are convertible or inconvertible, depending on whether the government pledges anything to redeem them or not. Lesser political divisions are usually denied the privilege of paying their debts by issuing paper money. The propriety of resorting to this method of borrowing by governments is not a subject for consideration here.

Paper
money.

The chief causes of public debts are war expenditures, and public improvements. Until recently governments borrowed chiefly to defray the expenses of war.

Causes of public debts. Now these are declining in importance in comparison with expenditures for industrial improvements and other public improvements of a constructive character.

INVESTMENT CREDIT

The fourth division, investment credit, or capital credit, as it is sometimes called, is represented by real estate investments consisting of bonds and mortgages, bonds and shares in public service utilities, bonds and shares in general industrial securities, and shares in banking and in trust companies. Investment or capital credit is a long-time loan. In investment credit, the corporation or business receives funds from individual investors in exchange for a title to property. The term investment credit expresses the point of view of the lender, as loans are made purely for purposes of investment. An investigation of investment credit would take us into the entire field of the money market and of speculation, but our purpose is simply to state what it is, explain its nature and its relation to mercantile credit.

Until a few decades ago, capital was invested in business enterprises by those who assumed directly the management of business with the hope of making good profits on their successful management. Since then,

with the development of corporations, and especially those on a large scale, a great deal of the capital invested in business is contributed by those who are not active participants in business, but who advance the capital with the hope of making only fair profits. This so-called general investor is increasing in importance now, and by all odds the largest portion of capital is invested by men of this class. In the single entrepreneur system large-scale production with its advantages was impossible. With the partnership organization, the business unit could command a larger amount of capital, but disadvantages of the partnership organization prevented it from becoming the prevailing form of organization for large undertakings. The corporation became the most advantageous institution for large units of production.¹ It could attract capital from a great variety of investors because (1) they are not responsible for the obligations of the corporation beyond the amount of their subscribed stock, (2) they can buy shares in small amounts, and (3) they can withdraw from the corporation at any time by selling their stock at its market value. Moreover, the corporation has an advantage from the point of view of organization, as it is relatively stable and permanent and it can concentrate its executive management in a few very competent men.

The railroad business in the United States which represented the first great demand for large scale production and consequently for the corporation form of organiza-

¹ See Ely: *Outlines of Economics*, p. 148.

tion, finds the corporation in almost exclusive control to-day. Corporations produce nearly three-fourths the total product in manufacturing industry and an increasing number of mercantile establishments are corporations. Nearly all banks, insurance and trust companies are corporations. Nearly all municipal utilities under private control, are also corporations.

The property of corporations is in the form of stocks and bonds. Bonds give their holders a preferred claim to the assets of the company and the interest on them must be paid regularly. There are several kinds of bonds depending upon the character of the guarantee of the funds loaned. The stock is divided into common and preferred shares, although many corporations do not issue the latter. The preferred stock when issued has usually a prior claim over the common both to assets of the business and to earnings, and in such cases dividends cannot be declared until the holders of preferred stock are paid their interest in full. A further discussion of the investments in corporations is not warranted by the limits of the present chapter.

From the point of view of the investor, investment credit and public credit are identical. Both are long time loans and upon each is realized usually a low rate of interest. Both appeal to practically the same class of investors. But from the standpoint of the agency enjoying the credit the two kinds are different. In public credit the

lender buys bonds when he believes that the government is willing to pay, and has resources sufficient to enable it to pay its obligations. In capital credit the investor buys bonds or stocks when he believes that the business is sufficiently profitable to enable it to pay its debts. Because the securities of many kinds of capital credit fluctuate in value, many investors are attracted to this class of property by the hope of its appreciation in value.

Mercantile credit is radically different from investment credit. As the former is a short-time loan, the rate of interest is usually high, the loan is made not as an investment but because the sale of goods upon which the profits of the merchant are made, requires the loan. Upon the other hand, the power to command credit by institutions in investment credit and in mercantile credit arises from a very different set of forces.

Ordinarily investments in real estate mortgages are the safest long-time loans of investment credit. The investments of building and loan associations are in this class of property, and as the loans are for considerably less than the value of the property, they are considered safe. The securities in banks, trust companies, and insurance companies are considered a safe investment, but of course here much depends upon the character of the institution. Of the investments in public service utilities, those in railway stocks and bonds are perhaps now the safest. However, in the early history of railway develop-

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ment in this country these were considered an unsafe investment. The investments in municipal utilities such as the securities of street railways, telephone, waterworks, gas and electric lighting companies are more or less precarious, as it is difficult to find out the values of the property of the companies, the capacity of the companies to carry on a successful business, and ultimately the ability of the companies to pay at maturity. Stocks and bonds in these companies fluctuate frequently, and individuals who make such loans take chances. More uncertain than loans to public service companies are loans to general industrial enterprises. The status of the companies engaged in industrial enterprises is difficult to discover, and on that account this sort of investment or loan is more precarious. The so-called industrial securities as investments have arisen to importance in recent years, as may be seen from the fact that nearly one-half the property listed on the New York Stock Exchange is of this character.

The funds to carry on the above-named enterprises come from a variety of sources, and each sort of an investment has its respective interests. Those who are required to make safe investments at low rates will seek of course the safer investments. There is an opportunity, however, in investment credit for people of varying grades of speculating instincts. The chief support of these investments is coming now from business men who have funds to invest and do not care to manage business directly themselves. Such investors canvass the money market carefully, and distribute their investments in

such a way as to yield a fair profit without taking too great a risk. These investors expect a lower rate of interest than when they manage a business themselves in which they have invested all of their wealth and lose all they have in event of failure.

CHAPTER IV

MERCANTILE CREDIT

MERCANTILE credit is the power to secure goods for purposes of exchange in return for a valuable consider-

ation promised in the future. A sale of goods

Definition of mercantile credit. on time is a mercantile loan. Mercantile credit includes the credit given to facilitate

the distribution of products from the time they are in a raw state until they pass into the possession of the retailer. In this discussion the selling of goods on time by the retailer is not considered a mercantile loan as the goods in this instance are usually purchased for purposes of consumption, and the credit given is not for the purpose of facilitating the transfer of goods. However, this personal or consumption credit is closely related to mercantile credit as the soundness of the latter depends in large measure upon care exercised in giving personal or consumption credit.

From production to consumption goods pass through the following hands: the grower or original producer,

Classes of middle men. the selling agent or broker, the manufacturer, the wholesaler, the jobber, and the retailer. When goods are imported the importer is a

distributer between the manufacturer and wholesaler. Of course the great bulk of merchandise is not now handled by all these middle men. However,

some products even now are handled by all of them and of those that are not handled by all these middle men, some are handled by some of them and others by other middle men. The tendency now in reducing the cost of marketing goods is to eliminate classes of middle men with the result that the amount of credit given to market goods is lessened.

The grower or producer of raw materials is frequently compelled to resort to a loan to cover the period intervening between the production of goods and the time they are sold or when pay is received for them. In the sale of such products as grain, cotton, etc., credit is given as a rule and both the farmer and the commission man receive advances before funds are received from the sale of goods. The manufacturer may buy his raw material on time in which case he receives a mercantile loan. Again after his goods are manufactured it may be necessary for him to wait a limited period after they are sold before he receives pay for them. The importers, the wholesalers, the jobbers, the commission merchants, each in turn often buy goods on time thus receiving mercantile loans.

Merchandise in the hands of the manufacturer or the mercantile factors is capital, and when it is parted with for a promise to pay funds in the future, capital has been loaned in as true a sense as when funds pass over the counters of a bank in exchange for the promise to pay in the future. The commercial world is so organized that the majority of the distribut-

Who re-
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Depend-
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ing factors require the advancement of funds to help bear the expenses of handling and marketing goods, and to cover the time until payment is received for goods sold. The manufacturer sells goods to the wholesaler on thirty, sixty, or ninety days time, and accepts the note of the latter for the amount of the sale or writes a bill against him. This instrument is then frequently taken to the manufacturer's banker and is discounted. The wholesaler may sell to the retailer under the above-named conditions, and may also have his banker discount the instrument of credit. In each of the above instances banking institutions are called upon to advance funds to support mercantile loans, and at these points banking credit supplements and supports mercantile credit.

The most important change introduced by the modern methods of buying and selling is the system adopted by which credit is given. In the first half of the nineteenth century, in the United States, when the jobbers and manufacturers were visited by retailers twice a year to purchase goods, they could understand through a personal acquaintance of the buyer the nature of the loan given. Then the jobbers and manufacturers were not doing business on so large a scale as now, the buyers were fewer in number and the sales were much less frequent. The buyers were compelled to travel long distances over inferior highways or by slow boats on rivers and canals, and as they purchased but twice a year they were compelled to buy large stocks of goods much of which was

unsalable as it was difficult to anticipate a season's demands especially when the community was a changeable one. Goods were purchased on time, the buyer giving his note for the purchase which was paid in six or eight months when he returned for his next season's purchase. Long time credits were the custom then owing to the industrial conditions that could not be avoided which confronted the buyers. Then as now, manufacturers and jobbers sold their customers' notes to their bankers. In foreign trade long terms of credit also prevailed in periods of slow vessels and of slow methods of communication between trading centers.

The introduction and wide extension of the railway and the introduction of better means of communication by mail service, the telegraph, and telephone have revolutionized the methods of marketing goods and also the mercantile credit system. Whereas before the retailer had to make long trips to the market and have his goods shipped at great hazard over rough roads, the better means of communication and transportation have reversed the situation as it is considered more advantageous to have the manufacturer and the jobber sell the buyer and bear the risks of conveying the goods to him. At present the instances are exceptional where the buyer and seller come together. Goods are sold by traveling salesmen who visit the various buying localities, using samples to make their sales, or else they are purchased by the buyers through correspondence and not by visiting the houses of manufacturers and jobbers as formerly.

Causes of
changes in
granting
mercantile credit.

The long term of credit of from six to twelve months has given way to the short time loan of from thirty to ninety days. Mercantile agencies have developed to make known the credit standing of the buyer to the seller and the latter no longer depends upon a personal interview with the former to judge of his credit standing. In the large jobbing and manufacturing institutions a department has been developed whose special function is to investigate the standing and character of those seeking credit and to collect time accounts. In the smaller institutions not of sufficient size to warrant the establishment of a separate department, this function is, nevertheless, carefully performed.

Our present credit system grew out of distinctly modern conditions. Prior to the 19th century inability

Conditions under which credit was given formerly. to pay a debt was frequently a criminal offense and the offender was thrown in prison. The state of Georgia was organized by a colony of delinquent debtors who were given their liberty if they would leave England.

Virginia and other states were largely settled by indentured servants—those who became, in a sense, slaves to their creditors until the obligations of indebtedness were removed. The farther we go back in history the more rigid we find the laws against debtors. Inability to meet an obligation as it matured was considered one of the gravest of offenses. The laws and practices of the early maritime cities of Italy, Venice and Genoa, bear evidence of the power of the creditor class. The Shylocks were not merciful. So long as

these harsh measures prevailed the giving of credit required but little judgment, and the development of a credit system was unnecessary. The risk was wholly the debtor's of assuming the responsibility of meeting an obligation at a certain time.

In our present industrial era the harsh treatment accorded to the debtors of two or three centuries ago would be absolutely impossible. Present conditions make the debtor and creditor in a sense partners in enterprise. Credit is given not as a favor to the debtor but with a view to profit. The old idea that the debtor owed the creditor in law and in fact is passing away. The creditor investigates the character, ability, and financial standing of the debtor, the nature of the enterprise in which the capital is to be invested, and calculates on the likelihood of the debtor's being able to meet his obligations at maturity. He thus becomes, in a sense, his partner in the business and in event of failure willingly accepts a cancellation of a portion of the debt, providing that there has been no fraudulent conversion of the assets.

The complicated organization of modern industry requires credit giving. Business could scarcely be carried on for a day without it. The element of chance seems to play a much more conspicuous rôle than when business organization was simple. The spirit of venture finds no more enticing field than in some departments of business. The success, too, of many of our great captains of industry may be traced to the taking of great

The
granting
of credit
at
present.

risks. This element of risk is responsible to a large extent for our industrial advancement. It is thus easy to see why credit giving should, in the nature of things, be considered a necessary part of business transactions and why the debtor who failed honestly should be considered simply an unfortunate investor.

The rise of corporations which take the place of partnerships introduces another change which has its reflex influence on credits. As long as the partnership remains family honor and family pride count for much in avoiding the bankruptcy court. In corporations the identity and importance of the individual are not conspicuous. "Stockholders and managers of corporations frequently screen their credit and honor behind joint stock companies, and in event of failure often pose as unfortunate investors in disastrous enterprises." Hence, with this change is introduced another reason for scrutinizing carefully the standing of concerns seeking credit.

Corpora-
tions in-
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of credit.

It is extremely important, since credit plays such a conspicuous rôle in industrial life, that it should be on a high plane. To this end the reporting agencies have been developed, credit and business men's associations have been organized, and the government has thrown about the creditor certain safeguards—all to make it as difficult as possible for the debtor to be dishonest, and to minimize losses due to mistakes in lending.

As soon as business was organized, so that it was no longer possible for the seller to meet the buyer face to face and to learn the nature of his business standing

directly from him, agencies were organized to investigate the standing of those seeking credit. Now they are absolutely essential to credit giving. No merchant would think of granting credit without investigating the standing of the buyer as reported by the agencies. All dealers are consulted once or twice a year by the representatives of the commercial agencies for desired information for the purpose of establishing their rating, and if the information is unsatisfactory, others are consulted. When goods are sold by a traveling salesman to some new firm, the house, before shipment, investigates the standing of the firm as reported by Bradstreet or Dun or other agency. If the report is not altogether satisfactory the attorney of the company in the locality investigates his standing. The advice of the banking institutions with whom the debtor deals is always considered important. Other methods which will be discussed later are used.

Some time ago 500 letters were sent to a nearly even number of manufacturers, jobbers and retailers for the purpose of learning the practices relative to discounting, credit giving, and related subjects in different parts of the country. Over 30 per cent. of these people replied and upon their communications the following facts are based. The relations between the manufacturer and jobber are simple. Jobbers who handle the lines of any manufacturer are comparatively few, and it is easy to learn their standing. When the manufacturer sells to the retailer his interests in giving credit are

Sources of
credit in-
formation.

identical with those of the jobber whose dealings are with the retailer.

Payment within ten days is usually considered cash. Beyond this, payments range from twenty days' time to

Terms of credit. over a year. One and two months' time is usually given on groceries. On tea, and coffee in bulk, three and four months are often allowed. On dry goods and textiles generally the average term of credit is longer. The longest term of credit is given on agricultural machinery, and the payments are often arranged to be made in installments.

What determines the term of credit. The comparative terms of credit on the different lines of goods have an economic basis. No reason exists for extending credit beyond the time when the buyer sells his goods. Mercantile credit is given primarily to enable the buyer to pay for goods from the proceeds of their sale. As groceries may be turned in one or two months, the ordinary term of credit on them is from thirty to sixty days. It generally requires a longer period for the sale of textiles and a longer term of credit is consequently given. Farm implements are sold by retailers to buyers who usually need several months in which to pay for them, and these payments are usually arranged to come at times when crops are sold. In the case of some other commodities the urgency is not so great for granting credit to the consumer, wherefore, the retailer is inclined to permit his credit relations with the consumer to be determined not by the consumer but by the manufacturer and jobber.

Various methods are employed by manufacturers and jobbers to learn the standing of the retailer. All of them use the information furnished by the leading commercial agencies. Aside from this their methods vary. In giving credit to new customers some require a definite statement from them of their financial standing. Others learn what they can from their traveling salesmen. Still others find out what they can from the local bankers and from other houses with whom the debtor has dealings. Then, too, manufacturers and jobbers are often organized in credit men's associations which are more or less clearing-houses of information with reference to the credit standing of their customers. So in a variety of ways the financial ability and character of the retailer are learned.

Sources of
informa-
tion.

The rate of discount for cash payments varies as widely as the term of credit. It varies from 6 per cent. to 72 per cent. a year, while the average annual rate is between 12 and 18 per cent. In fixing discounts for cash, manufacturers and jobbers may wield a ready weapon to force cash payments. As a rule the longer the term of credit, the higher is the rate of discount, because the more uncertain the payment of the obligation. Discounts on groceries average about 12 per cent. a year, on textiles about 18 per cent., while on certain kinds of jewelry the rate is as high as 72 per cent. a year.

The rate
of dis-
count.

High rates are levied to cover losses by failures. When conditions are normal, manufacturers and jobbers know approximately what losses they will sustain through

failures, and therefore, adjust interest charges to cover these losses. Those who do not fail are compelled to pay

Interest rates cover losses. the debts of those who fail. If we consider rates natural in which the excess above the general rates prevailing on money loans pay

the losses of bankrupts, it often happens that the natural rate deviates from the customary rates. There is frequently a tendency to cling to cash discount rates when the excess of these rates above the prevailing ones more than pays the losses through bankruptcies. The manufacturer and jobber are often interested on this account in having the debtor take the full term of credit rather than pay cash.

Another reason for the divergence between the so-called customary and natural rates lies in the character

Why rates on mercantile loans are high. of the merchant's business. From the very nature of his business he has usually but a limited amount of property upon which he can secure advances of capital. The value of his

goods, relatively speaking, is a high percentage of the value of the plant. So the scope of his business as a merchant is limited directly by the extent to which he goes into business loans. On this account discount rates may be excessively high to compel purchasers to resort to the regular institutions of loan.

It seems apparent that it is to the interest of the retailer to cash all his bills with money borrowed from banks. Many do this, and consequently save from 6 to 12 per cent. a year on purchases. The lack of capital of many retailers and the difficulties in the way of

borrowing at banks, exclude them from this opportunity. To put the matter in another way, the ease with which commercial loans can be secured as against the difficulty of securing bank loans is responsible for the high rates of the former and the low rates of the latter. Banks loan only on good collateral, on personal security, and to those who have excellent credit standing. The retailer's purchases are comparatively frequent, so that the difficulties in the way of obtaining good security closes this route of escape from high interest charges on capital borrowed. There are, however, other merchants whose credit at bank is good and who habitually allow the term of credit to expire before payments are made. In doing so considerable is lost by not appreciating the difference between the bank rates of interest and the rates charged by lenders of merchandise.

The credit instruments most commonly used in mercantile credit are bills of exchange, promissory notes, and book accounts. In the first instance the seller of goods may write a draft ordering the buyer to pay the amount of the bill a given number of days after sight. If the latter accepts it, the seller of the merchandise after endorsing the bill may sell it at once to his banker as double-name paper, or to some one else in the settling of his bills. The promissory note may be used in practically the same way except that the purchaser of the goods signs a promissory note to pay the amount of the bill in a given time. In this case as in the former one, after the seller of the goods endorses the note it may be sold to his

Credit instruments.

banker or to some one else, usually one to whom he owes an account, as double-name paper. The use of such credit instruments as bills of exchange and promissory notes makes it possible for the seller of goods to secure funds at once upon credit instruments which are an evidence of a loan of thirty, sixty, or ninety days. Moreover they are often used as mediums of exchange cancelling many obligations and thus dispensing with the need for money.

Notes or bills based upon mercantile loans have always been considered good bankable paper, and in many communities the bulk of bank loans are based upon these credit instruments. As mercantile loans are always connected with a sale of goods it is not possible for merchants to maintain as high standards of credit while selling goods as may be maintained by banking institutions whose business is devoted almost exclusively to the making of loans. The diverse conditions under which mercantile credit was given and the lack of system on the part of merchants in giving credit, made it impossible for banks to handle all classes of commercial paper offered to them for sale. Consequently there has developed a specialized class known as note brokers to facilitate the sale of commercial paper. The note brokers made a study of the value of commercial paper a specialty, and consequently became experts in this department of credit. Acting as middle men, they purchased commercial paper from business houses and sold it to banking institutions. Where banks were unwilling to accept single-name paper,

note brokers often either act as endorsers or else secure endorsers for these notes. It frequently happens at present that no bank will make a single loan in such amounts as large mercantile houses desire in order to make a cash purchase. In such instances the mercantile house will call on a note broker who executes several notes and sells them to a number of financial concerns. While the note broker came into existence when mercantile credit was given for from six to twelve months he has come to be an important factor in mercantile life with the changed organization of business.

The third form of mercantile credit is the book account which is frequently used in the case of sales between merchants. When a debt is due the account is usually settled by a check upon the purchaser's bank. Book accounts are taking the place of promissory notes and commercial drafts but they are not as serviceable to sellers of merchandise in enabling them to realize at once upon accounts where time is given for the payment of bills. The promissory note and the bill of exchange can be sold at once. The seller of goods may sell his book account or borrow upon it, but it is more difficult to sell it or borrow upon it than it is to sell either the bill of exchange or a promissory note. When either of the latter is sold its genuineness is attested by the signature of the maker of the paper and when both the note and bill are endorsed, as is usually the case, two parties are pledged to the payment of the instrument. Upon the other hand the purchaser or assignee of the book account must depend for

Book
accounts.

its validity on the representation of the man who sells it or who borrows upon it, and on this account the latter must be well known to the former.

A regular system has developed of lending on book accounts, and in some instances commercial banks maintain separate departments to pass judgment upon the value of this class of accounts, while in other instances brokerage houses, or commission houses, have developed to negotiate loans upon book accounts. Prendergast claims that "it is probable that this method found its inception in a practice, introduced some years ago, whereby a house having no other form of collateral to offer its bank, and being much in need of money, induced its bank to accept an assignment of certain accounts. Advances were made by the bank to an agreed percentage of the gross amount of the accounts assigned."¹

There are three methods by which the man who sells merchandise on time may realize at once on his book accounts: 1. He may sell his book account outright, in which case the purchaser assumes all risks and charges high interest rates and also a bonus proportioned to the degree of the risk. 2. The seller of merchandise may assign his book account and borrow upon it up to a certain per cent. of the value of the account. The assignor in this case permits the borrower to collect from the funds assigned, and, in place of these, others may be assigned to the bank to keep up the ratio agreed upon. Of course in this case, if the assignor should fail or if for any reason the credit

¹ *Credit and Its Uses*, p. 115.

relations between the borrower and lender should be broken, the assignee would proceed at once to collect the assigned accounts. 3. In another case the assignee may advance funds to a certain percentage of the value of the account and charge a heavy interest rate and a bonus for the service rendered. The funds obtained by the borrower in this instance are secured under more unfavorable conditions than in the former one. In most of the latter cases a higher interest rate is exacted than in the former case, and, as the lending institution collects the accounts, the selling house suffers somewhat in its reputation, as its customers are made aware of the fact that its accounts are assigned and that it does not enjoy a high grade of credit; whereas in the method described in (2), the borrower collects his own accounts and his customers have no knowledge of the assignment of accounts.

In still another case where book accounts are assigned, the assignee may proceed at once to collect the accounts.

Commission houses have developed in recent years to deal exclusively in book accounts; and, as they advance funds and discount accounts, they are in this respect bankers. Their numbers in large commercial centers attest the profitableness of the business in which they are engaged. Many of them have back of them wealthy banks and trust companies which find in the advancement of funds to these institutions, a lucrative field of investment.

Commis-
sion
houses
deal in
book
accounts.

The rates charged are a further evidence of the difference in rates between regular banking loans and mercantile loans.

An important change has been introduced in the system of credit giving by the practice of dating ahead.

Dating ahead. An impression prevails that dating ahead and credit giving are the same. On the contrary,

they are distinct, although directly related. When we depended upon foreign countries for the bulk of our manufactured goods, it was necessary for the importer and jobber to carry all lines in stock which were sold to the retailer. When the American manufacturers began to supply the consumers it was learned that there would be a clear advantage in selling all commodities, not staples, before they were produced. Such commodities as sugar, flour, and the cruder kind of textiles can be kept in stock, as the demand for them is comparatively regular. But changes in fashion and difference in kind of commodity with the consequent uncertainty of demand, makes the production in advance of all products not of the staple type a hazardous enterprise, and producers are unwilling to take the risk.

The method of procedure in dating ahead is as follows: The manufacturer or wholesaler goes to the retailer in the fall and takes orders for spring and summer goods. After the orders are taken the goods are produced. The goods are dated, we will say, February 1, but the manufacturer ships the goods to the retailer as soon as they are manufactured. If the goods are paid for within ten days of the first of

**Method of
dating
ahead.**

February, then payment is usually considered cash, and all payments are dated from February 1. But the retailer may have the goods in his possession before the first of the month and some of them often as long as six weeks or two months prior to the time the goods are dated. In a sense, dating ahead prolongs the term of credit by the interval between the shipment and dating of the goods. The keeping of goods in stock compels retailers to increase their insurance account. In all cases where goods are sold before the time of dating, an advantage is gained. However, in such cases competition between dealers often results in extending credit to consumers. So the system of dating ahead is not only an extension of credit itself but it indirectly results in the prolongation of the term of credit.

Mr. Prendergast, in *Credit and Its Uses*, gives a somewhat different interpretation of dating. "The discontinuance of 'long time' such as four, six, and eight months, has had the effect of introducing the feature of 'dating' into commercial transactions and credit. A 'dating' of thirty days or sixty days indicates that the term of credit, whatever it may be, does not begin to date until the expiration of the term of dating. For instance, a bill sold and charged on January 1, 1906, with a dating of sixty days—terms, 2 per cent. ten days and net thirty days—is not due until April 1, as the dating does not expire until March 1, and the terms being thirty days carry it to April 1. The purchaser has the option of paying it whenever he chooses, but payment cannot be insisted upon until April 1. A merchant purchasing a bill

under the foregoing terms would, if he were in a position to do so, pay the bill at the end of ten days (January 10), deduct his 2 per cent. discount, and also deduct interest at the rate of 6 per cent. per annum for the unexpired term of sixty days (the dating), of which time he has not availed himself."

This author then assigns other reasons for dating. Whether "dating" grew out of an endeavor to shorten the term of credit, as it undoubtedly did, in many cases, or has other reasons for its existence its effect is always the same, it really extends the term of credit.

Aside from prolonging the term of credit, dating ahead increases credit giving. When the goods are dated ahead they cannot be sold C. O. D. Under this system it is not always within the power of the seller to dictate the terms of payment. When the goods are not shipped C. O. D., if the buyer should refuse to pay within ten days, the term of grace usually allowed for cash payments, the only recourse of the creditor is either to refuse to have further dealings with the buyer or to institute proceedings to collect the account. Injury to the buyer's standing by recourse to either of these methods may often be adequate to force him to abide strictly by his contract. The point of interest in this connection is that the system itself practically provides for credit giving.

The system has also another bearing on credit. The manufacturer is relieved of the necessity of taking chances on production. As goods are shipped as soon as produced, he is also relieved of the necessity of carrying

insurance on the stock. However, these advantages may be counteracted to a certain extent by interest accounts on long period datings. As soon as dating ahead came to be generally practised, competition extended the period of the dating. This meant for the producer a prolongation of the interval between production and sale, if we consider the sale for practical purposes to take place when the goods are dated. The traveling salesman is out taking orders, and the goods are produced long before they are paid for. It matters not for our purpose whether we consider this an increase of interest account of capital expended, or an extension of credit. The result is the same. In dating ahead the producer has the advantage of regularity, certainty and avoidance of risk in an extension of credit.

In dating ahead the risk is transferred from the manufacturer and wholesaler to the retailer. In the effect of the system on the mind of the retailer we find another influence tending to increase both credit transactions and the number of failures. The longer you postpone the time of payment the more reckless and indifferent people are in giving orders. Purchasing unnecessary and unsalable goods results in an enforced extension of the term of credit. Failures to a very large extent result from having in stock unsalable goods.

Since the ending of the crisis in the United States fifteen years ago there has been some agitation favoring a shortening of the term of credit and the abandonment

Advantages of dating ahead to manufacturers and jobber.

Influence of dating ahead on retailer.

of commercial credit wherever possible. The organization of the business community practically forbids making much headway in the latter movement. However, much advancement has been made in the last ten years in systematizing the methods of giving credit and in minimizing losses resulting from credit giving.

CHAPTER V

PERSONAL CREDIT

PERSONAL or individual credit is the power of an individual to secure something of value in the present for a promise to pay in the future. It includes credit used to secure production as well as consumption goods, and the credit of partnerships as well as of individuals. Its most common kind to-day is the credit secured at the retail store; that is, the power to secure goods in exchange for a promise to pay in the future. It is also used to secure medical, legal and other expert service, and to borrow money which may be used for a variety of purposes, chiefly of an individual or personal character. Because the things procured by personal credit are used largely for individual ends, or for purposes of consumption, it is sometimes known as consumptive credit. In this discussion personal credit is given a broader meaning.

It is sometimes difficult to state at what point mercantile credit ends and personal credit begins. The purchasing of goods on time for purposes of final consumption, from the point of view of the buyer is clearly a case of individual credit. Should the sale of goods on time by the retailer be placed in a different category than the sale of goods on time by either the manufacturer

Definition
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personal
credit.

Personal
and mer-
cantile
credit
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trasted.

or the wholesaler? When the manufacturer sells to the wholesaler on time, the latter often desires time in order that he may pay for the goods from the proceeds of their sale. Credit is granted by the manufacturer and requested by the wholesaler to facilitate the sale of goods. In this sense the function rendered by credit is quasi-public if we assume that a social service is furnished in the distribution of industrial products. A similar condition prevails when credit is given the retailer, as in theory he is granted time to enable him to pay for goods from the proceeds of their sale.

The retailer does not give credit to enable the purchaser to pay for them from the proceeds of their sale, because in the case of consumption goods they are bought not for sale but for consumption purposes. The sale of goods on time by the retailer is not considered mercantile credit, as time for payment is not given to facilitate their future sale. In the case of production goods sold by the retailer, a variety of reasons determine the giving of credit and the terms of credit. In some instances credit is granted in order that the goods may in part pay for themselves. In the case of producer's goods sold for farming purposes, the time of payment usually coincides with the period of marketing farm products. In general, credit is given by the retailer because the buyer is unable to pay cash, whether the goods he buys are for production or consumption purposes.

The success of all the distributors from the manufacturer to the retailer depends upon the payments by the final purchasers to the retailers. Although the goods

purchased from the retailers on time are usually put to a different use by their buyers than the goods purchased by the preceding groups in the chain of distribution, the sale in each case is a loan of goods, and the final payments to the retailers serve to cancel the preceding obligations incurred upon the same goods by the preceding groups of distributors. I do not mean to say that the manufacturer and jobber must wait until goods are paid for by consumers, but that the whole superstructure of mercantile credit breaks down if the final purchaser is unable to meet his obligations. Mercantile credit and personal credit are so closely related that a complete consideration of the former warrants a treatment of the latter.

Personal credit is given to a large multitude of people under a great variety of conditions, and the laws governing the dispensers of personal credit are likewise various. The system of selling on time by retailers, the methods of investigating the standing of those seeking credit, and the influence of the extension of credit upon methods of selling and upon the prices of goods, will be considered.

When personal credit is used to secure money, the lender may be an individual, a partnership, a corporation, or a banking institution. When the lender is a bank, a confusion may arise between banking credit and personal credit. It is in possessing credit, or in manufacturing credit, that a bank's chief function as a

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Banking
and
personal
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credit institution consists. However, its capacity to create credit depends chiefly on its skill in granting credit; while individuals, partnerships, and corporations, are the grantees of credit by banking institutions. The borrowing of funds by an individual from a bank is a personal credit and not a banking credit transaction.

Personal credit of early times enjoyed credit although they did not possess what might be called a credit system. In the hunting stage of society those successful in the chase loaned to their unfortunate neighbors. At this time charitable impulses inspired lending. The borrower returned either in kind or in money the amount of the loan without paying interest. The public sentiment of the primitive community required that the wealthy should help temporarily those who had suffered misfortune and that no interest charges should be made for the advancement of funds. This public sentiment had at first the binding force of law. Later when interest charges were made by the few who took advantage of the poverty of those who sought credit, nearly all the early nations passed laws forbidding usury and imposed severe penalties for usurious charges. The literature of the times teems with discussions on the iniquity of the lender whose wealth grows at the expense of his less fortunate neighbor.

So long as loans were made chiefly to borrowers who were in desperate circumstances who were compelled to meet obligations at an appointed time and were unable

to do so without borrowing, the sentiment and the laws against usury prevailed. When industrial development had assumed a new form, when people borrowed money to invest in industrial undertakings, the former views with reference to usury passed away. When the borrower obtained funds to invest in profitable undertakings it became obvious that those who had saved and hoarded their funds were entitled to a share in the profits of the business in which their money in the hands of the borrower was invested. This new development gave rise to our present views of loans and of interest. Personal or individual credit has thus preceded all the other forms of credit and gradually merged into mercantile, capital and banking credit.

To-day it represents the most varied and unsystematic kind of credit. The people who receive personal credit represent all stages and conditions of life. As nearly all people receive credit at one time or another, a classification of those who receive personal credit would include practically the whole of the human race. The wage-earner is granted credit from his grocery store until Saturday night when he receives his pay. Those who work for salaries which are paid monthly often receive credit either from necessity or convenience, and if the time of payment coincides with the period when income is received, the term of credit in this case should be longer than when income is received weekly. Professional people and men of means are granted credit because it

What
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interest
charges.

Classes
that
receive
personal
credit.

is more convenient to pay in large amounts than to carry funds and pay on each occasion of purchase. Each of these classes lends itself to a great variety of sub-divisions, consequently the number of classes seeking personal credit place insurmountable obstacles in the way of classifying them.

Personal credit is likewise granted by a great variety of institutions and classes of people. The retail institution giving the greatest amount of credit is the grocery store. Purchases at the grocery store are made very frequently, sometimes several times a day in cities and towns, and it is consequently inconvenient to pay cash on each occasion of purchase. The grocery store is a community institution and it is assumed that the management has a better knowledge of buyers than in stores where purchases are not made so frequently and where the retail institution is not to such an extent a community institution. Credit is obtained at dry goods stores, drug stores, hardware stores, etc., but not so often as in the grocery store for the above-named reasons. As groceries are life necessities we find another reason why it is difficult to refuse credit to those who have been by misfortune suddenly rendered unable to pay their debts. The uses of things which are purchased of retailers have much to do with the granting of personal credit and the terms of personal credit. The use of dry goods, drugs, hardware, books, etc., are not often absolutely essential to life and consequently the need to give credit on these things is not so imperative as on groceries. Hardware and imple-

Who grants personal credit.

ment products are chiefly producers' goods and the use to which these things are put determines largely the conditions of credit. Personal credit is often given for the professional services of lawyers, physicians, etc. In the very nature of things some credit must be given for these services as the service is rendered on the installment plan and payment cannot be expected until the service is completed. Personal credit is often given in the form of a loan of funds in which the purposes to which the funds are to be devoted may or may not be stated as a condition of making the loan. As no rules of classification can be very easily applied to either the receiver of personal credit, the giver of personal credit, or to the purposes to which the borrowed funds are devoted, it is difficult to lay down any definite rules which govern the granters of personal credit.

The conditions under which goods are sold make cash payments in many instances inconvenient if not impossible. First, let us take the case of the retail grocery store, the institution which gives the greatest amount of personal credit. As a rule, groceries are delivered to customers. Competition between stores has led the great majority of them in our cities to send delivery boys to homes to take orders or to use the phone to secure orders for daily deliveries. The house-wife, too, uses the phone to order goods. This is done frequently several times a day. In all these cases it is impossible for the retailer to receive cash payments on the delivery of his goods, and the cases are exceptional

Why it is
necessary
for
grocers
to give
credit.

where he does receive cash. In a great minority of instances are goods purchased by those who visit the grocery stores. Even in these instances groceries are purchased so frequently that it is inconvenient to carry funds to make cash payments. Those who visit grocery stores to make purchases in most instances give orders also by phone or to the delivery boy who visits the home of the customer. The circumstances surrounding purchases in the regular grocery store make cash payments almost an impossibility. When cash payment is not made for goods, the salesman furnishes to the purchaser of groceries a bill or account itemizing the things purchased with the price of each. In some instances those who have a credit account at a store carry an account book in which the salesman makes a list of the things purchased with the price of each on the occasion of each purchase.

As an exception to the rule that grocery stores give credit, a number of stores, especially chain stores, do a

~~Some grocery stores do not give credit.~~ strictly cash business. However, to sell only for cash many of them do not deliver goods thus requiring the purchaser to come to the store to take his purchases home with him.

To conduct a cash business and to decline to furnish a delivery service requires such stores to sell their goods much cheaper than goods are sold at the regular grocery stores.

In other retail institutions as dry goods, hardware, shoe, drug, clothing, gents' furnishing, and department stores, the giving of credit is not so common. However, in practically all of these stores except the hardware

and gents' furnishing stores, the great bulk of goods is purchased by women or other members of the family than the breadwinner who ordinarily has charge of the finances of the household. It is much more convenient for those who purchase to buy on credit than to pay for goods. Moreover, the custom of paying by check rather than by cash is greatly on the increase. Those who can get credit allow their bills to run till the close of the month, and it has become the accepted practice of the great majority of retail institutions to render an account at the close of each month to their customers who have been given credit. They then receive checks from their customers shortly afterward which are returned to them receipted. This has become almost the regular way of making payments for public utility service such as for heating and lighting and for other kinds of service such as laundry, cleaning, etc.

Where the custom exists of rendering an account at the close of each month a ready weapon is at hand for the creditor to enforce prompt collections. The debtor is presumed to pay his bills at the close of each month when the accounts are rendered. If he refuses to do so the retailer can either insist on prompt payment or withhold credit from him in the future. The postponement of the payment of accounts, and the running up of bills beyond the capacity of the debtor to pay, may often be traced to the carelessness and the indifference of the retailer who gives credit.

Personal
credit
given by
other
stores.

Creditor
responsi-
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habits of
payment
of pur-
chaser.

The position of the retailer is wholly different from that of the manufacturer and jobber in giving credit.

Factor determining the granting of credit by retailers. The manufacturer and the jobber must rely on mercantile agencies and other sources of information to learn the standing of their customers, while the investigations of the retailer are more direct. The methods of the retailer depend upon his location, and the character of his trade. The retailer often knows personally all his customers, of their ability to pay, of their promptness and of their credit worth. In large cities where dealers have a great variety of customers, and in small places where there is a transient trade, their credit problems are more difficult. The usual method of procedure when an applicant for credit appears is to ask for references to other dealers with whom the customer had credit relations. Others investigate if the customer has property. Some give credit on the evidence of honesty judged from a few moments' conversation. Still others will grant credit after learning where the man works and of his ways of spending his money. In some cities retailers are organized in local credit men's associations, and through these organizations they avoid making loans to irresponsible persons. The range of losses varies with the class of creditors, the kind of business, and the section of country. Some say that only 1/2 per cent. of their total sales are uncollectable, while others place this percentage of loss as high as 5 per cent. It will be seen that the information which determines the granting of credit by retailers is derived from a great variety of sources.

The following are some of the reasons why credit is given unwisely by retailers:

1. Many retailers are anxious to do a large business and to give external evidences of doing a very prosperous business. To attract many customers it is necessary to give them credit on easy terms and to deal leniently with them in making collections. Such retailers compete with each other to carry on an extensive trade, establish easy standards of credit, and demoralize the personal credit market.

2. Other retailers do not keep adequate books, do not know the costs of conducting their business, and do not know their credit losses. Bradstreet's estimates of the causes of business failures show that approximately one-fourth of them are due to incompetence, and failure to keep books is mentioned as the first evidence of incompetence. It is safe to say that if retailers knew the costs of giving credit they would be more conservative in this department of their business activities.

3. Fear of driving away customers deters many retailers from making adequate inquiries regarding the credit standing of those who wish to buy on time. As there is no recognized system or method of inquiry, retailers are timid about making necessary investigations of the credit worth of their customers, and the latter are inclined to resent such investigations. If there were a customary method of procedure by retailers, seekers for credit would accept as a matter of course all legitimate inquiries concerning their ability and willingness to pay their debts.

4. As personal credit has been given in a haphazard way no definite knowledge exists with reference to the right basis for personal credit. The conditions of wealth, of character, of ability to pay, of family status, etc., which should determine whether credit is to be given at all or how much should be given, are factors which have never been adequately investigated. Again the poverty of the consumer or in other words his inability to pay, is often a reason for giving credit by some retailers. It is difficult for a grocer, for instance, to refuse credit to a wage-earner who has always paid his debts promptly, but who, through the loss of his position has been suddenly rendered unable to pay his debts.

5. There is also a great lack of knowledge of the need for credit. This does not apply to buyers who pay their bills monthly as a matter of convenience instead of paying cash for each individual purchase, but to those who do not pay promptly because they have no funds with which to pay. Retailers seem hopelessly ignorant as to whether their customers are able to pay cash or when they are able to pay. As consumers pay no more for goods they buy on time than those for which they pay cash there is no inducement for them to pay cash as long as credit is given them.

6. Retailers have ordinarily no facilities to find out the credit standing of their customers. When manufacturers and jobbers give credit to retailers they may proceed with greater accuracy as mercantile agencies furnish information on the credit standing of all businesses. Moreover, they have other sources of information

which are described elsewhere, on which they can safely rely. Those who receive personal credit as stated above consist of the rank and file of humanity, and no facilities have as yet developed to learn their credit standing. It is safe to say that if retailers had the opportunity they would learn if their customers were worthy of credit or not.

What is said here does not apply to department stores and other large retail institutions that employ agents to investigate the standing of applicants for credit, and who employ some system in granting credit. Moreover, retailers along several lines in some of our cities have formed organizations to exchange credit information and these give credit with a great deal of care. The work of these associations will be discussed later under the subject, Credit Exchanges.

It has been stated that there are no definite principles to guide the retailer in determining upon credit risks. As far as can be learned retailers are governed by three sets of conditions: 1. character; 2. wealth and earning power; 3. character, habits of payment, habits of life, and habits of spending or buying.

In no division of credit does so much depend on the character of the applicant as in personal credit. In other cases, wealth and ability to pay are primary requisites. In personal credit a man without wealth or apparent ability to pay may receive credit if it is known that he is honest, that he treats his financial obligations very seriously, that he

What de-
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the
granting
of credit.

Character.

would be willing to do almost anything than to fail to pay his debts. Such a person may enjoy excellent credit whereas one of considerable wealth but who is slow in making payments, may not have good credit.

The latter class usually enjoys good credit because in cases of emergency, debts can be collected, and frequently **Wealth and ability to pay.** a declaration of intention to take legal action is sufficient to secure payment. Individuals with ability to pay, but without wealth, are usually those of good incomes obtained by salaries or as fees by rendering personal service. Those whose income is secured through fees are professional men as lawyers, physicians, dentists, etc. These men ordinarily enjoy good credit because as a rule they receive good incomes and their professional honor and standing in the community demand that they meet their obligations promptly. Those who work for salaries are chiefly ministers, teachers and those engaged in a high grade of work in industrial pursuits. As they have regular salaries it is not difficult for them to adapt their expenditures to their income. As long as their salaries continue, a convenient means is always at hand to a retailer to collect payment by attaching the salary.

The previous record of the customer is perhaps the safest guide to the retailer in giving or in withholding credit.

Habits. If the seeker for credit is delinquent in making payments, and if it is difficult to collect from him, credit is either given him unwillingly or it is withheld. Where credit cooperation methods prevail, this factor is considered very important and the customer's

record with other retailers in this respect is taken into account when he solicits credit. Upon the other hand, if the consumer pays his debts promptly, a limited amount of credit is given without any reference to his wealth or his ability to pay.

The habits of life of the buyer and of his family are also important factors determining what credit should be given. Habits of life include personal habits, habits of industry of the bread winner, and habits of economy or of extravagance of his family. It is sufficient to say that if the bread winner has good habits and is industrious, and his family does not live beyond his means that ordinarily good credit will be enjoyed. Upon the other hand, if just the opposite conditions prevail, or any one of them, such a family should be given either no credit at all, or very limited credit.

Closely associated with the extravagance of a family as a guide to credit giving are habits of purchasing. If a family purchases unwisely, that is, purchases what it does not need or purchases in excess of its needs, it is an argument in favor of either denying or limiting the amount of credit given.

The extensive granting of credit has an important influence on extravagance. Compelling customers to pay cash imposes on them the obligation to adapt their expenditures to their income. Where they can postpone the time of payment, this postponement begets a spirit of extravagance, goods are purchased beyond the power of payment, and an artificial demand is created for goods

Granting
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extrava-
gance.

not warranted by the ability of consumers to pay for them.

In mining districts, lumber camps, and in some manufacturing towns a kind of personal credit has developed which has become peculiarly reprehensible on account of its influence on the working men. In these centers the companies owning the plants own also some or all of the stores and often the homes where the wage-earners live. Credit is freely given at the company store and when the wage-earner's income is received, practically all of it goes to pay for groceries, drygoods, rent, etc. On account of low wages and the free granting of credit, the wage-earner is frequently behind in his payments for these things and when credit has become imperative for him, he buys exclusively at the company stores, and because he is not free to purchase anywhere else he pays excessive prices for his goods. To prevent this kind of exploitation, many states have passed laws either prohibiting company stores altogether or else requiring that the prices charged by company stores shall not be in excess of the prices charged for similar things at competing stores.

Installment sales is another form of credit which is used persistently at the present time. Household goods, furniture, clothing, books, pictures, jewelry, insurance, etc., may be purchased in installments, and some houses are organized specifically to sell their products in this way. The usual plan is to require a cash payment and then a certain amount each month until goods are paid for. An

agent usually makes periodical calls to obtain these installment payments. For larger purchases the buyer usually gives a chattel mortgage, and in the event of failure to pay the debt, the company may take not only the goods sold, but also the pledged chattels. In case of small purchases no mortgage is given, and the seller recovers the goods sold when the buyer fails to make his regular payments.

The evils of installment sales are twofold: 1. It is notorious that of all goods that are sold those purchased on the installment plan are obtained with least reference to the needs of purchasers. Only a dollar a month, is a bait which has induced many an extravagant purchase. In the mill and mining towns, organs, pianos and victrolas are purchased by wage-earners on the installment plan, and prices are paid for these things out of all proportion to the income of working men's families. In all cities a great variety of things are sold to poor people for which they have very little need, because the burdens of payment seem to be light because they are distributed over long periods of time. 2. The expenses of selling on the installment plan are heavy, and the consumer pays the extra costs of selling. If a chattel mortgage is given some expense is incurred in writing the mortgage. If the goods are sold by agents, the traveling expenses of these agents must be paid. As the installments are usually paid to agents the cost of collection by these agents must be borne by the purchasers. As the losses from installment sales are greater

The evils
of install-
ment
sales.

than from other sales, these excessive costs too, must be borne by the installment purchasers who pay their obligations.

The chief advertisement of many retail houses is "We will give you credit" or "Your credit is good."

How credit is given carelessly. When this inducement is offered to buyers, the sellers cannot exercise reasonable care in distinguishing between those entitled to credit and those not so entitled. Moreover, other stores send out notices to prospective customers made up from lists without any reference to credit standing, telling them that their credit is good at the stores. Such loose methods in giving credit stand in the way of positive reforms in systematizing personal credit.

The burdens of unwise credit, in the end, rest with the consumer. High prices to consumers, which mean a high

The consumer bears the burden of unwise credit. cost of living, are traceable in part to the costs of giving consumers credit. Personal credit is responsible for high prices in the following ways: 1. Consumers who pay their bills pay in terms of higher prices for the goods of those

who do not pay their bills. Retailers who give credit must secure a fair income for what they sell, and on this account prices are placed high enough to cover all losses and to make a reasonable profit; so that those who pay will eventually pay the bills of those who cannot pay for what they buy. It is on this account that many consumers who pay cash refuse to patronize stores that give credit, realizing that they are paying other people's bills. 2. Where goods are sold on time

an interest rate is charged, and the prices paid cover not only the value of the goods but also the interest charged on the loan pending payment for them. 3. The cost of maintaining a credit system, including the cost of keeping books and of collecting bills, is added to the price of the goods.

It is difficult to estimate the extent to which goods are increased in price by the costs of the credit system.

Mr. Daniel B. Murphy¹ of Rochester, New York, quoting from reports of Mercantile agencies showed that the annual losses from financial failures in the United States from

Credit
and high
costs of
living.

1890–1899 averaged \$178,871,026.70. He further states that “These stupendous figures—appalling though they be—do not include the untold millions that are absolutely lost each year by merchants engaged in retail trade, in every line of industry, in every town and cross-road, from ocean to ocean, from the lakes to the gulf, comprising every retail enterprise from the gigantic department stores in our great cities to the humble rural dealers. These figures do not include the very considerable loss sustained by those engaged in the learned professions—notably by the physicians of the country—nor do they include the enormous losses of a personal and confidential nature, that are not submitted to the gaze and scrutiny of the public.”

¹ The objects and possibilities of Credit Men's Associations, 1900.

CHAPTER VI

THE CREDIT MAN

THE credit man, like many of the leading factors of to-day, came into prominence as one of the inevitable con-

Organiza- sequences of expansion of trade and concentra-
tion of tion of industry. Before the traveling sales-
mercan- man evolved, the area of trade occupied by the
tile jobber and manufacturer was comparatively
industry. narrow. The merchant visited the house,
made his purchases, and, after a face to face meeting of
buyer and seller, the terms of payment were arranged.
When the merchant ceased to visit the jobber and manu-
facturer, the simple way of arranging payments was aban-
doned. The traveling salesman now stands between the
mercantile agency is one of the chief sources of informa-
tion on the credit standing of the retailer. The territory
over which the manufacturer and jobber transact busi-
ness has been greatly extended, and much has been
gained in the rapidity of business methods. The rapid
means of transportation, the lowering of the charges of
shipping, and the improvements in communication, have
all been responsible for this enlargement of markets.

These changes have introduced the credit department
into all large jobbing and manufacturing houses. The

head of this department, after he has made a careful investigation of the concern seeking credit, is intrusted with the task of approving or rejecting its orders for goods. To him is intrusted also the duty of watching all accounts, of collecting them when due, or of extending the time as the conditions seem to warrant. In all houses not of sufficient importance to have a regular credit department the work belonging to such a department is carefully managed by other departments.

Work of
the credit
man.

The purpose of the credit man is to keep the percentage of losses at a low point. To do this not only must he exercise excellent judgment in granting credit, but he must be a good collector. A low percentage of losses is not necessarily the criterion of a good credit man. He who refuses all orders except from those houses whose standing is known to be absolutely reliable drives away much profitable trade. So he is compelled to give credit to a class of merchants whose credit standing is not of the best, but upon whose trade the profits exceed the losses. It is upon orders from such a class that he must repeatedly exercise his judgment as to whether the probabilities of profit exceed those of loss. The other part of his task lies in the application of skill in collecting accounts. Vigor and persistence in following up delinquent debtors and tact in handling them are requisites for every successful credit man.

In order to accomplish these things the credit man must be in possession of a very broad range of facts. He relies upon several, sometimes all, of the following sources

of information: reports of mercantile agencies, the traveling salesman of the house employing him, the attorney of the house, an attorney in the community Sources of of the dealer, the debtor's banker, firms with information whom the debtor has dealings, and the statement of the debtor. All these means of procuring information are open to the credit man, and he uses them as conditions warrant.

The credit man must be familiar with the laws regarding indebtedness in the states in which his firm deals,

Laws of and must know exactly the methods of procedure under the national bankruptcy law. different states. In deciding upon terms of contract, the laws

of the state must not be violated. Houses often fall into endless difficulties because, not having adequate knowledge of the state laws concerning indebtedness, they fail to collect many of their debts. A knowledge of the laws of the states is of value, not only in making terms of payment, but also in assisting the collector to determine upon proper methods of procedure. If the business methods and customs of states and localities differ, the credit man must be cognizant of these facts, and must understand thoroughly the business peculiarities, if any exist, in each locality in which his firm has business dealings.

He must be familiar with the industrial, and competitive conditions upon which the success of the merchant depends. He must know what need there is for such an institution in the city or the part of the city where the merchant is located. He must know if the

competition in the debtor's line is very severe, or if he is located in a splendid field for his business. It is very generally believed that department store and branch store competition, and the competition of merchants who purchase collectively in some cities, make the existence of certain classes of dealers precarious. In certain cities these competitive forces act more strongly in certain lines than in others. These are factors which must be taken into account by the credit man in giving credit.

Industrial
conditions
where
credit
applicant
lives.

Furthermore, the industrial character of a community has much to do with the probability of success of the dealer. If the community is conservative, the likelihood of the dealer's being able to pay his debts is much greater than if it is not. However, there is much less probability of great success in such a community than in one of a different type. If the merchant lives in a manufacturing city and his customers are to a large extent wage-earners, his ability to pay will often depend upon the continuous employment of wage-earners. The character of the industries of a city with respect to furnishing continuous or intermittent employment exercises much influence upon the dealer's ability to pay, and over this influence he has little control. If the wage-earner is not furnished continuous employment, he cannot pay his store bills regularly.

If the dealer lives in an agricultural community or if he depends directly on agricultural trade, crops and prices are important items to be considered. In such

places there is always a close association between crops, prices, and trade. If crops are poor or prices are low, **Agricultural conditions and credit.** the farming trade falls off heavily. This is strikingly true where the dealer does not handle the necessities of life. But whether necessities or luxuries of life are handled, more credit is sought under these conditions than when prices are high and crops are good. The general welfare of the community has much to do with the character of the goods consumed, but this is a problem with which the credit man is concerned only in so far as it permits him to judge of the purchasing ability of the merchant seeking credit.

The certainty of the ability of the merchant to pay is measured, everything else being equal, by the character of the customers—whether regular or **Character of customers.** transient, whether made up of the wealthy, middle or lower classes. Transient customers are more likely to pay cash. However, if credit is given, the percentage of loss is greater with transient than with regular customers. Losses are greater upon the less well-to-do than upon the middle and upper classes. All these are factors which the credit man takes into consideration in estimating the ability of the debtor to meet his obligations.

The credit man acquires also a knowledge of the character of the particular industries seeking credit. He must know the capital required for a given business, its running expenses, and the line of credit that ought to be carried under the given industrial conditions. From

his knowledge of these things he judges of the safety of the business which the merchant is conducting.

One drawback to success is the absence of bookkeeping and the inadequacy of accounts that merchants keep, to show the exact status of their business.

Many failures can be traced to these causes alone. Merchants frequently do not know from their books whether their business is profitable or unprofitable until it is too late. Good book-keeping is, and ought to be, an excellent aid in revealing wherein success or failure lies in business methods. Failure to keep books hides from the credit man the real status of the firms with which he deals. He knows that in giving credit the probability of loss to him is greater when a merchant does not keep books than when he does. On this account the credit man must often discriminate against such a merchant.

Book-
keeping
and credit.

As the ideals and moral standards of communities differ, credit men must consider the character of communities. If a great many business men in a community have failed, and most of them dishonestly, it is fair to assume that the moral tone of such a community from a business point of view is not high. Social control plays a prominent rôle. Many dishonest failures are an evidence of easy standards of honor. They show that the public opinion of the community has been on a plane too low to pursue relentlessly those whose business morals are low. The record of the merchant and his family is a matter of importance. The man who has not

Moral
standards
of the
commu-
nity.

failed and whose family record is clear, views with compunctions of conscience the taking of steps which may lead to the bankruptcy court.

It is not difficult to determine the honesty of a merchant. The character of his dealings with the house of the credit man or with other houses and that of his dealings in the community in which he lives, reveal his business character. If a man has been in business some time, his business morality is well known. If he is a beginner in business it is more difficult to determine what he would do under given conditions; but judgment upon his business morality is based on his previous record.

The way in which a man secures his money is also a determining point in judging of his ability. If he has earned

Business ability and credit. his money it is fair to assume he will conduct a sufficiently conservative business to guard against losing his capital. The fact that he has

earned it is itself sufficient to stamp him as a man of ability to produce and of some business sagacity. It is recognized not only in business, but in everything else that the only way to learn to do, is by doing. When essentially new problems arise, the chances of doing wrong equal, if they do not exceed, those of doing right. Nothing insures success in any business better than past experience in dealing with all the problems that are likely to arise.

There are those who seem to think that, for a man who has capital to start with, business experience and business sagacity are unnecessary for success. To the

prevalence of this theory may be traced a comparatively large percentage of failures. Many act upon the assumption that the business of merchants is simple. Although they have failed as traveling salesmen or in other fields, they think that if they can get the capital to begin with, they can certainly succeed as merchants. Credit is given sparingly to such men. Another class has made a thorough study of business methods and has learned the details of business through experience as employees. When men of this class begin business, even with borrowed capital, the presumption is favorable to success.

There are thus four classes of men who begin business: (1) Those who have earned their capital as employees, in which capacity they may learn all the details of the business. (2) Those who have learned the business as employees, but who begin on borrowed or inherited capital. (3) Those who have earned their capital in other pursuits, but who bring to the business no experience in it, and no knowledge of the business methods which prevail there. (4) Those who have not earned the capital, have no experience in the business, and who know little or nothing of business methods. Only experience and ability to produce entitle a man to credit. The second class is probably more likely to receive credit than the third. Experience in a business, a knowledge of its details, is of more importance to a merchant than having earned capital in other lines.

After a merchant has been in business for some time the conditions under which he started are always con-

sidered. However, the credit man has facts more tangible to act upon. He can judge of the merchant's ability as a producer from his sagacity in handling the business. The amount of capital in the business, the running expenses, the character of the books he keeps, and his methods in general, furnish the credit man a criterion upon which to act.

A knowledge of a man's credit standing in his own community is very important to the credit man. If a debtor can borrow at his bank and can carry a good line of credit, his credit standing is certainly good. If he is able to pay his debts, but is habitually in debt, and always allows his terms of discount to expire before payment is made, there is not only a strong evidence of carelessness in business, but also of a lack of business sagacity. When a merchant allows terms of discount to expire before payment, he is conducting business with capital upon which excessive rates of interest are paid, and the business is consequently less profitable than it should be. If he sells on credit without a careful investigation of the standing of his customers and is careless in making collections, the losses in his business are unnecessarily high. His treatment of his customers, his methods of advertising, the organization of his clerical force, the general appearance of his place of business, are all things pointing in the direction either of success or of failure.

The merchant's sagacity as a buyer is something upon which credit men are well informed. If he is an easy buyer, he will over-buy and have on hand goods which he

cannot sell except at a loss. If he lacks judgment in adapting his purchases to the demands of his customers, he will always have on hand unsalable stock.

As said before, merchants are agreed that in a large number of cases failures are due to having a large supply of unsalable goods. Although jobbers will always sell to merchants unsalable goods, the weakness of the latter in purchasing is considered a reason for discriminations against them in giving credit.

The conditions under which bank and mercantile credit are given are practically identical. In some ways the jobber has the advantage of the banker in knowing the producing ability of the merchant, an advantage which he gains by his opportunity to base his judgments upon the character of the merchant's purchases and in his skill in bargaining; in other ways he is at a disadvantage. As a banker lives in the same community as the merchant, he is in a better position than the jobber to know a wider range of facts concerning him. Then too, money has acquired the right of dictating conditions in bargaining not yet attained by merchandise. It is clear why this is true. The banker's reputation for conservatism must be maintained or the purposes of the institution are defeated. The bank holds in its keeping much of the capital of the community, and consequently borrowers are willing to concede the bankers all precautions necessary to safeguard not only themselves but also their customers. Bank failures entail a more serious disorganization of business than a failure of a jobber or manufacturer.

Ability as
a buyer.

Bank and
mercantile
credit.

Another difference in the relative power of dictation of the banker and jobber is to be found in their competitive conditions as bargainers. As a rule the jobber goes to the merchant to sell, while the borrower of a bank visits the banker. Loans of merchandise are always connected with sale. Money loans, upon the contrary, are independent of other transactions.

Since the right to be inquisitive on standing, character, etc., is more clearly conceded to the banking than to the commercial houses, it is given to the banks to fix the degree of perfection which our credit system attains. If they are loose and careless in granting credit, it is impossible for the commercial houses to be strict and careful. To the banking institutions, then, are given the responsibility to a large degree for better customs, a better credit system, and better relations between creditors and debtors.

Upon receiving orders from a merchant who has had no dealing with the house and whose credit standing is un-

**Value of
the signed
statement.** known, the house usually requires a signed statement from the merchant. Merchants frequently refuse to give signed statements, believing that requests for them challenge their honor. This feeling, however, is passing away. Merchants whose credit standing is good are coming to see that a refusal to make a statement injures their standing. If they can pay cash, a signed statement is unnecessary. If they cannot, it is to their interest to have the best terms of credit a condition which can be secured only by making clear that they will pay their debts. Merchants

are coming to see that their best interests demand a fair statement of the conditions of their business, and credit men have discovered that the signed statement is the most effective means of guarding against losses.

When the merchant goes into bankruptcy, a signed statement in possession of the creditor gives him a decided advantage. A false statement gives a creditor a legal right to bring action to protect his claim either by attaching the property of the bankrupt or of rescinding the sale. In the latter case the title to the goods does not pass to the debtor, and the creditor has the right to recover their value, provided that enough remains in stock. To do this it must be proved that the debtor knowingly made a false statement without any grounds for believing he could pay for the goods. Fraudulent intent is the basis of civil action under the national bankruptcy law. If the debtor was insolvent at the time the goods were purchased and the statement was made, an evidence of fraud appears, and the burden of proof is placed upon him. As false statements are damaging to debtors, statements in the hands of creditors improve their chances in collecting bad debts.

The work of the credit man in investigating the standing of merchants is frequently defeated by the failure to keep books. If a merchant does not know his own financial standing it is impossible for him to give the credit man an accurate report. However, the demands of the credit man for accurate statements are a strong incentive on merchants to keep books and to know their financial status.

Failure to
keep
books.

Those who took the census of small manufacturers and traders for the United States Census Bureau, learned that a great majority of them did not keep books. On this account these manufacturers and merchants were unable to state the few facts concerning their occupation which the United States Government wanted to know for its statistical report of 1900. A great many of these people did not know the extent of their liabilities or their assets, and did not know whether they were conducting profitable or unprofitable businesses.

Some claim that we ought to have a system for verifying accounts controlled by a public accountant; that

Books examined by public accountants. all dealers should be required to keep books to be opened to inspection at least once a year by accountants appointed by the state or national governments. Since credit rests on the confidence one man has in another's ability to pay, a good credit system cannot exist without a knowledge of the debtor's resources and liabilities. If a simple and thorough system of accounting could be devised, it would be an excellent trade barometer to a business house. If such a system were practicable it would relieve the credit man from solving many perplexing problems.

Credit men occupy a unique position in industrial society. In the methods employed, they either induce **Importance of the work of credit men.** a healthy moral tone or else are responsible for practices which result in heavy losses. Merchants who buy on time, and who need not be particular in paying when accounts are due, are likely to overstock and to buy unsalable

goods. Credit is also granted indiscriminately by them, and they are careless in collecting. Here is seen the utility of prompt collections. When merchants receive credit sparingly and must pay promptly, they are careful in granting credit to consumers and are careful in collecting. The reactions inhibited by promptness on the part of credit men are thus wholesome. Looseness in giving credit over-gluts markets, while looseness in collecting produces habits of indifference and carelessness in business which degenerate eventually into business immorality.

CHAPTER VII

CREDIT OFFICE

THE purpose of the credit office is to procure, organize, and classify the right kind of information so as to make it immediately available to the credit man.

Purpose of credit office. This chapter will deal with the mechanics of the credit office, the sort of filing cases to be used and the records to be kept, and also with the class of information to be secured, its classification, and its uses.

The organization of the credit office depends very much upon the nature and size of the business, the number of credit customers, and somewhat upon the habits and inclinations of the credit man. The mechanism should not be so extensive as to be cumbrous, nor should it be inadequate for the purposes of the office. It should provide for such a system as will supply the credit man with the information he needs with the least amount of effort.

For the large offices there have been worked out very definite systems which differ somewhat in detail but which agree on the general method of recording and filing information. A typical system is the following: A large cabinet is provided for filing information in which are placed large envelopes vertically, each envelope containing all the information

on each credit case. Each envelope has a number corresponding to the number of the case. A cabinet containing the regular sized filing cards is also used. The cards are arranged alphabetically, each containing the name of a credit case, and each bearing a number corresponding to the number on the envelope in the large cabinet.

The simplicity of the system commends it. When some one applies for credit, the alphabetical arrangement of the small cards enables the office clerk to turn at once to the card bearing the man's name, and the number on the card enables him to turn at once to the applicant's envelope in the large case which contains all the information possessed by the office on the applicant. This method corresponds to those used by charity organization societies, and many business houses, for filing information. When a new customer applies for credit his name and other data are written on a small card, which is placed in the cabinet in its appropriate place. The number of the case is written on a large envelope, which is intended to contain all the information concerning the applicant as soon as it is collected.

The large envelope usually contains the property statement made out by the applicant for credit, the information obtained by the traveling salesman, the information given by the mercantile agencies, and information furnished by references given by the applicant and by all others from whom the credit man solicits information. A record of the credit given the applicant together with all other information concerning the history

of the business which may be gotten from trade papers and a variety of sources is also placed in this envelope.

The character of the information which should be placed on the small card is a mooted question. Much depends on the use the credit man desires to make of it. It may be used primarily as a reference to more complete information in the large filing case; or it may be a complete record of information for certain purposes. In the latter case it may contain the name, the address, the business, the rating, the terms of credit formerly given, and a few of the most important facts usually furnished in a property statement which should indicate the credit standing of the customer.

Not all credit men keep record cards. If the volume of business is large and the number of customers is

Office systems differ. small, no elaborate office machinery is necessary to follow each case. Again, there may be a large number of accounts and a small num-

ber of individuals to whom sales are made; in this case it is necessary to keep but few records. But even where there are a large number of sales and many customers of a house, the practices of credit men differ widely. Perhaps the majority of credit men do not use card catalogues at all. Most of them have some sort of filing cases or use letter folders where they file away the information they have on each credit applicant. Again, many credit men look over their ledger accounts of the candidate before passing judgment upon a request for credit. However, in an office where a great amount of business is transacted,

everything favors the use of card catalogues and filing cases as a means of saving the time and energy of the credit man, and of permitting him to give accurate judgments without delay on applications for credit. If the credit office is to have its greatest utility, the records must be kept up-to-date, and this will require considerable activity from some member of the credit office staff.

The committee on Credit Department methods of the National Association of Credit Men has been laboring for a number of years to get out suitable property blank forms. Blank forms to be used by salesmen in obtaining information from customers, attorney's report blanks, and blank forms to be sent to persons given as reference by applicants for credit have been devised. A great variety of blank forms is used for all these purposes. It was the intention, however, of the above-named committee, after receiving suggestions from many sources, to devise such an inquiry form for each purpose as would enable the credit man to obtain all the information desired with as little annoyance and inconvenience as possible to the one called on to make a report. These forms have been revised frequently and have been submitted from year to year to the National Association. As they represent the best judgment of credit men for the purposes for which they were intended, they will receive consideration in this discussion.

A property statement is one usually made by an applicant for credit over his own signature showing the nature

Credit
inquiry
forms.

and kind of property he possesses, his assets, liabilities, etc. The property statement is considered valuable as a basis for credit for two reasons: 1. no one **A property statement.** is as familiar with the financial status of the applicant for credit, his assets and liabilities, as he himself is, and no one has the same right as he has to give such a statement; 2. a signed statement which misrepresents the facts pertaining to the possessions of the applicant and his financial status, makes him criminally liable for obtaining goods under false pretenses if he fails to pay his debts. A great deal of effort has been made in recent years to make it customary for the seller of goods to demand as a right a signed statement from the applicant for credit. The latter often has some one else in the office sign the property statement, but in some states the man who fails to pay his debts cannot be held criminally liable for a false statement of his property which he did not sign personally.

The blank form for a property statement is very desirable in order that the right kind of information may be secured. Otherwise, the applicant for credit makes such a statement as suits his purpose. With a blank form before him, a refusal to sign all questions makes it embarrassing for the buyer, as any omission gives the credit man a right to inquire why the desired information was withheld.

Form I gives the property statement form recommended by the Committee on Credit Office Methods of the National Association of Credit Men. All property statements contain the same essential elements. This

form calls for a more detailed report of the finances of the applicant for credit than most property forms.

The two chief divisions of the report are the active business assets and the business liabilities. Under the former head are included the value of the merchandise, the notes and accounts due the business concern, its cash in hand and in bank, and the value of its fixtures, machinery, etc. Under the head of business liabilities are included what is owed for merchandise, what is owed in hand, what is owed others for borrowed money, and what is owed for taxes, rent, and on mortgages, for fixtures, etc. Other assets included in the report are the real estate free from encumbrances, personal property, etc. An opportunity is then given the applicant for credit to state the grand total net worth of his business.

Property
forms.

It remains then for the credit man to make proper deductions from the notes and accounts receivable and also from the inventory of the merchandise and other capital. In considering the inventory the items should be valued at cost, because the prospective selling value is always an unfair estimate for an inventory. If the fixed property, including buildings, furniture, fixtures, etc., has depreciated in value, the inventory should show the true selling value of such property. It will be shown hereafter how other phases of the property statement guide the credit man in judging the value of the inventory.

Much depends on the character of the assets of the company seeking credit, because the character of its

What portion of real estate described is homestead _____

Have you any other debts than herein mentioned? _____

Full given and surname of each partner	Age?	Married?	Possible liability of each member of firm as endorser, bondsman, etc

What kind of business do you conduct? _____

Insurance on stock _____ On fixtures, machinery, horses and wagons

On real estate _____

Amount of sales last year _____ Amount of expenses
last year _____ What proportion of your sales is on credit? _____

Date of last inventory _____ Have you any judgments, judgment
notes, chattel mortgages, or other liens against you, recorded or unrecorded? If so, describe

_____ If you have pledged or transferred outstanding accounts or property
remaining under your control, state amount thereof and amount received, or to be received
on account of such pledge or transfer _____

What books of account do you keep? _____

Buy principally from following firms:

Name	Address	What line of business?

The above statement, both printed and written, has been carefully
read by the undersigned, and is a full and correct statement of my or our
financial condition as of _____ 191 _____.

Firm signature _____

By whom signed _____ a member of the firm.

All questions must be answered, insert ciphers in absence of any amount. When the
words "Yes," "No" or "None" will correctly answer the questions, write them in their
proper places.

A-2

FORM I.—(Continued.)

assets determines in large measure its paying ability. If the seeker for credit is overstocked, as a rule he will

Character of assets important. be slow in making his payments. If a considerable portion of the capital of the trader which should be invested in the business is invested in outside interests, as real estate, stocks, etc., these investments should be very carefully examined by the credit man, as they may be of vital concern in determining whether the applicant for credit is worthy of it or not. It is generally conceded that credit men do not give sufficient attention to the assets of concerns seeking credit.

For convenience in determining the credit worth of candidates assets should be divided into two classes: live or quick assets, and slow or fixed assets. "The first class consists of that character of property for which there is a steady demand, or for

Live and slow assets. which under all ordinary circumstances there is a ready market; or property which can be converted into money or utilized for credit purposes on short notice. Such assets are represented by cash, marketable merchandise, good book accounts, securities, and any other character of personal property subject to expeditious sale. Slow or fixed assets are those for which there is not a ready sale, especially such property as is not of constant utilization in the course of business. They consist of furniture and store fixtures, buildings, real estate and machinery, and investments which are of a developmental or speculative nature."¹

¹ Prendergast: *Funds and Their Uses*, p. 228.

While credit men are agreed on the distinction between the two classes of assets, much difference of opinion exists among them with reference to the value of slow or fixed assets in estimating a credit risk. Some are inclined to consider them of no value whatever, while others would discount them heavily in estimating their value as a basis for credit. Still others consider that they have merit chiefly in case of a failing concern, as they materially assist, under such circumstances, in liquidating. Much, too, depends upon the character of the business conducted, and the general condition of industrial prosperity. If the business often needs capital on short notice, large investments in fixed capital are a disadvantage. In periods of depression it is difficult to dispose of fixed capital, while in periods of prosperity certain classes of fixed capital may be sold on short notice at good values. Everything, however, depends upon the proportion of slow to fixed assets, the nature of the business, the condition of prosperity, etc.

In property statement form (I) are many questions which when they can be correctly answered result in throwing much light on the nature of the assets of the credit applicant and his worth as a credit customer. It is important to know what portion of the real estate described is the homestead on account of the importance of the homestead laws of the various states.

One question calls for a knowledge of the insurance on stock, buildings, machinery, fixtures, **Insurance.** etc. The amount of insurance held is very important in determining a credit risk. A business man

may be perfectly solvent and doing a very profitable business and from every other point of view a good credit risk, but if he does not carry insurance on his buildings and his merchandise, he may be rendered unable to pay his debts in a very brief space of time by a fire. It is on this account that the property statement calls for a report on the insurance on goods, on buildings, etc. This feature is so important that no good credit man to-day would think of granting credit without a full knowledge of the insurance carried by the credit applicant.

The credit man should know in what company the property is insured and whether the insurance company is solvent or insolvent. He should also know the value of the goods carried by the merchant and whether this property as well as his buildings and other property are adequately covered by insurance. Some concerns require that their traveling salesmen obtain this information from customers when credit is requested, and practically all the property statement forms at present request this class of information.

The subject is deemed of sufficient importance by the National Association of Credit Men to have a standing committee on Fire Insurance. This committee has done efficient service in urging credit men to require merchants who desire credit to be adequately insured, and in securing where possible, better rates from fire insurance companies and in bringing pressure to bear to have merchants and communities take such precautionary measures as will secure to them better rates from insurance companies.

The property statement also calls for the date of the last inventory and some of them for the frequency of taking inventories. This is important to the credit man as he should know how often the applicant for credit estimates the value of his property. Moreover, as his report must be based on the last inventory taken, it is important to know when the values were placed on his property. It is further required that the applicant for credit state if there are any judgments, judgment notes, chattel mortgages, or other loans against him; also if he has "pledged or transferred outstanding accounts or property remaining under his control."

The property statement blanks made out by the National Association of Credit Men require the applicant for credit to state what books of account he keeps. This is important for various reasons. Failure to keep proper books of account is responsible for a great many failures, and when the credit man is asked to give credit he should know if the applicant for credit keeps books and what kind of books he keeps. This question is now of great importance on account of its relation to the National Bankruptcy Act, as under the Act a failure to keep proper books is an assigned reason for refusing a discharge to a debtor. Legislation in New York makes it an evidence of fraud if the debtor who has received credit upon the representation that he keeps books fails to submit his books within ten days after a requisition has been made upon him by a creditor whom he has failed to pay.

The property blanks of the credit department methods

Keeping
books.

Contingent Liability { Accommodation indorsements _____
Indorsed bills receivable and outstanding _____

OFFICERS.

Name in Full

Address

President _____ Vice-Prest _____
Secretary _____ Treasurer _____

DIRECTORS.

Name in Full

Address

Authorized capital _____ Subscribed _____ Paid in _____
How paid in: Cash, \$ _____ Other property _____ Description of
other property, and how valued _____

In whose name is title to real estate held ?
Incorporated in what State and under what general
laws or special act? _____ Nature of business? _____
Date of charter? _____ Suits pending, and of what nature? _____
Are any merchandise creditors secured in any
way _____ Amount of annual business _____ Annual expenses _____
Annual dividends _____ When was last dividend declared? _____ Rate _____
Insurance carried on merchandise _____ Fixtures and machinery _____
Real estate _____ Regular time of taking inventory _____ Keep
bank accounts with _____
Keep following books of account _____

If you have pledged or transferred outstanding accounts or property remaining under
your control, state amount thereof and amount received, or to be received, on account of
such pledge or transfer _____

Buy principally from following firms:

Name	Address	What line of business?

The above statement, both printed and written, has been carefully read by the
undersigned, and is a full and correct statement of our financial condition as of

191 _____

Corporation Signature _____

By _____

Date _____

All questions must be answered, insert ciphers in absence of any amount. When the
words "Yes," "No" or "None" will correctly answer the questions, write them in their
proper places.

FORM II.—(Continued.)

committee of the National Association of Credit Men require the signature of a member of the firm seeking credit in the name of the firm under the following affirmation: "The above statement both printed and written, has been carefully read by the undersigned, and is a full and correct statement of my or our financial condition." Property statement Form II is devised for use by corporations and is intended to procure practically the same class of information as is to be secured by Form I.

The credit man of any well-regulated office will not content himself with obtaining information from a single source but will collect information on credit applicants wherever it is available. The traveling salesman as a source of credit information will be discussed later. In order to secure the credit information desirable or possible for him to obtain, blank inquiry forms have been made out of which Form III is a sample. These blanks especially are relatively brief. They require the salesman to ask the buyer a number of questions and other portions of the blank can be filled out by the salesman himself. These blanks can be filled out quickly by the salesman, and it will at once occur to the reader which questions the salesman can answer upon observation and which he must ask the purchaser.

Attorneys residing in the locality of the credit applicant have always been a source of credit information. The work of the attorney enables him to possess a great deal of information of interest to the credit man. Special credit inquiry forms are

Local
attorneys.

The Campbell Iron Co.

New Customer Report

To be filled out and sent in with each new customer's order, or change of firm. Do this to help us make prompt shipments.

Date, _____ 19____

Sold to, _____

Address _____

R. P. D. _____ State _____

(Give Names in full.) Individuals if Firm, or Officers if Corporation.

AGE (about) _____ MARRIED _____

 " " " "

 " " " "

- | | |
|---|---|
| 1. Owns shop worth about \$_____ | 11. Refers to _____ |
| 2. Owns home worth about \$_____ | 12. Insurance \$_____ |
| 3. Encumbrances on above \$_____ | 13. Is location good? _____ |
| 4. Stock worth about \$_____ | 14. Does he get good profits? _____ |
| 5. Kind of Business _____ | 15. Banks with _____ |
| 6. Does owner devote all his time to this business? _____ | 16. Local crop prospects _____ |
| 7. What is local standing? _____ | 17. Is customer colored? _____ |
| 8. Has he good ability? _____ | 18. How long in business? _____ years. |
| 9. Does he drink or gamble? _____ | 19. What is your opinion of customer? (Answer on reverse side.) |
| 10. Has been dealing with _____ | _____ Salesman. |

FORM III.

Property statement form for use by salesmen.

Sub. No. 100.522

DETACH AND SEND REPORT BELOW TO

Expires Sept. 1, 1913

ART BRASS COMPANY,

299 E. 134th Street,

NEW YORK.



The above firm is a subscriber to THE MARTINDALE SERVICE and above date, and mailed to reports in accordance with our rules. Name of inquirer must not be revealed to party inquired about. Attorney will write name of party reported on blank line below, seal off and keep this stub, and in case of a failure or anything else occurring to affect the credit of said party, give prompt notice to above-named subscriber, and use due agency.

George W. Martindale
President

Name of party reported _____ Date _____ 19____

ATTORNEY WILL PLEASE DETACH, READ AND FILE THIS STUB, AND NOT DIVULGE NAME OF INQUIRER

Confidential "Form A"

To Watson, Stouffer & Davis,

New York, March 4, 1913. 19____

Attorney recommended by the Martindale Service, the Direct Screen between Merchant and Attorney

Expires Sept. 1, 1913

At New First National Bank Bldg., Columbus, Ohio.

Dear Sir:—Kindly favor us with as full a report as possible of the party, or firm, named below, which we pledge you we will treat in the strictest confidence. Mail to us in enclosed stamped envelope. We will gladly reciprocate your kindness whenever opportunity occurs. A prompt reply will be duly appreciated.

Subscriber's No. 100.522

Name _____

Address _____

1. Business? _____

2. Full individual names? _____

3. How long in business? _____

4. Habits and business ability? _____ Inclined to speculate? _____

5. Estimated value of stock? _____

6. Reput as to promptness? _____

7. Any home debts owing? _____ Any claims in attorney's hands? _____

8. Ever sued? _____ If so, give particulars? _____

9. Ever failed? _____ If so, give particulars? _____

10. Net unencumbered value of real estate? _____

11. Any resources outside of business? _____

12. What is your idea of net worth? _____

13. Getting ahead? _____ Holding own? _____ Going behind? _____

Other information _____

Continue report on other side or make report on your own stationery, typewritten if possible, but cover all points in your answer.

Form K 1

FORM IV.

Business statement form for use by attorneys.

manufactured for use by attorneys, of which form (IV) is a sample. It is the custom in some places to mail with the credit inquiry form a check for one dollar, which is considered a fair compensation to an attorney for the service he renders.¹

It is a common practice for new applicants for credit to give references to business men with whom they have had dealings. In the absence of special forms for this purpose the information solicited by the credit man varies greatly, is usually brief, and is likely to contain little of value. To suit this need Form V was adopted and recommended by the National Association of Credit Men. It is brief and self-explanatory.

Credit references.

The following is a typical method of procedure of the best credit offices in the opening up of new accounts. With his order for goods from a new customer, the salesman is required to send in his credit report of the customer. If the order is for immediate shipment and the salesman's credit report is complete and satisfactory, the goods will be shipped at once, and then a fuller report on the credit risk is obtained for future use. If the order is for shipment in the future or if the credit report of the salesman is unsatisfactory, a further investigation of the credit standing of the buyer is made at once. The standing of the credit applicant is investigated first in the reports of Dun and Bradstreet. If these are inadequate or unsatisfactory, special reports are requested

¹ This subject will be more fully discussed under the head of Sources of Credit Information.

RETURN THIS TO US

St. Louis, _____ 19____

Messrs. _____

Kindly give us below YOUR EXPERIENCE with

Name _____

P. O. _____

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,

GOOD FORM & CO.APPROVED AND ADOPTED BY
NATIONAL ASSOCIATION OF CREDIT MEN

MEMBERS NATIONAL ASSOCIATION OF CREDIT MEN

Sold Since _____	MANNER OF PAYMENT
Terms _____	Discounts
Highest Recent Credit \$ _____	Prompt and satisfactory
Owing Now { On Open Account \$ _____ On Notes, . . .	Slow but considered good
Past Due . . . { On Open Account \$ _____ On Notes, . . .	Slow and unsatisfactory
First Order, \$ _____	Pays C. O. D.
Other Information _____	Sell for cash only
 <p>This form can be obtained only from National Association of Credit Men, 41 Park Row, New York, at the following prices: 500 - \$3.25 - - 1000 - \$5.00</p>	
Account secured	
Notes secured	
Account closed for cause	
Makes unjust claims	
Collected by attorney	

FORM V.

Business statement form to be used by those given as references and others who have had business relations with credit applicant.

from either or both of these agencies. The credit report of the salesman should always contain a list of references given by the buyer. These are written to at once. Using blank forms similar to Form IV the office writes to an attorney in the town where the credit applicant conducts his business and also to an attorney in a town where he formerly conducted a business. A banker of the community of the buyer's place of business may also be written to with reference to the prospective customer. From these various statements and from the property statement obtained from the credit applicant prior to the shipment of goods or after they are shipped, the credit man determines whether credit shall be given and if so what the amount of the credit shall be. These reports are then all filed away in the large envelope used by the credit man for information concerning his credit customers.

Another document of value to the credit man in granting credit is the comparative property statement form. The larger mercantile houses and banking institutions appreciate the value of the comparative statement form. Well-organized credit offices require a property statement once a year from those who receive credit from them, and when occasion warrants it, more frequently. The comparative statement form is a large sheet in which is placed in a single column the essential facts from a property statement giving the financial standing of the applicant for credit. As the number of columns corresponds to the number of years

Comparative
property
statement
forms.

for which a comparison of standing is desirable, it is possible for the credit man to prepare a comparative statement form covering any number of years.

Where comparative statement forms are kept it is necessary for the credit office to have one comparative statement for each customer. The information from the property statement is usually copied by some one in the office.

Banks were the first to use the comparative statement forms, and they are used to-day by them to a much greater extent than by mercantile houses. This is perhaps due to the fact that credit customers of banks are more willing to submit property statements than are customers of mercantile houses, and the property statement furnished the bank conforms more to a standard type than those submitted to mercantile houses. The latter have only recently acquired the privilege of receiving property statements from their credit customers, and consequently the dates for comparative statements have been received only recently by merchants.

In the absence of a comparative statement the credit man usually compares the recent property statement with those of previous years. The comparative statement is valuable to him because at a glance he can compare the various elements over a series of years upon which a credit risk depends.

Credit lines or limitations. Banks and mercantile houses have for a number of years been granting to their credit customers, credit lines or limitations. These credit lines or limitations are the maximum

amounts which a banking or mercantile house will loan to a customer at any time. These lines are determined upon by credit men after a thorough canvass of the value of a customer as a credit risk.

When a credit line is determined upon, the policy of mercantile houses differs widely with reference to it. Some treat it as a danger signal and act accordingly. In some cases where the credit line is determined upon the bookkeeper alone passes on accounts only to see that loans are within the prescribed limits. In the great majority of cases, however, all loans within the credit limits receive the attention of the credit man, and to many it is deemed highly expedient that they should receive his consideration. The credit line should be considered a fixed or a permanent matter. It is subject to change, however, with changing conditions and circumstances, and if the credit man would fix these lines wisely, he must know about the purchases of each credit customer, the time allowed him for his payments, and his promptness in paying his bills.

Credit lines have not been standardized. What is allowed a customer depends somewhat on the whim of the credit man. So many factors enter into a credit risk that no definite rules have ever been evolved that will enable credit men to act with system in determining what credit should be granted. The conditions differ so widely in the sale of different classes of goods that rules which would guide credit men in granting credit to grocers might be very unsafe to hardware men. As a rule, lines of credit can be granted for larger amounts

where the terms of credit are for brief periods and where the goods are turned many times a year, than where the credit terms are long and where the stock of goods is turned infrequently.

When credit limits are fixed they are changed frequently or are not respected. The circumstances change so often that credit may be given to one customer far in excess of the credit limit, while another customer may be denied a loan up to the credit limit. The factors considered have to do with the extent to which the credit applicant is a customer of the house granting credit, with the terms of credit he desires, his promptness in paying, crop conditions, labor conditions, condition of prosperity, condition of competition where he conducts his business, opportunities for the business where he is located, and with the degree of prosperity of his business. An increase or a decrease of the credit risk, and a regard for the credit limit granted to a specific customer depend upon the above-named factors. Although subject to change, credit limits serve a useful purpose in controlling the policy of the credit man within certain limits.

Banking institutions are now establishing credit departments with credit men in charge. Some banks in our large cities have had such departments for many years; but it has only been within the last fifteen years that the credit department has been considered an essential feature in large commercial banks. Where such departments do not exist, the work of a credit department is handled by officers of a bank in connection with their other duties.

**Credit de-
partments
of banks.**

This is especially the case with the smaller banks of the country, and it is not at all likely that the smaller banks will ever find it profitable to organize an independent credit department.

In the interests of good banking there are many reasons for the organization of good credit departments: 1. Where loans are made by one or two officers of a bank, who use no system but retain valuable information in mind, this knowledge may be lost to the bank if the officer who has charge of credits dies or resigns. With a credit department and a credit system this information is preserved. 2. The profits of a bank are determined by the wisdom of its investments, and these are made at greatest advantage where those in charge of the investments have full knowledge of credit risks. 3. Large banks have also the responsibility of advising country banks which deal with them with reference to the value of commercial paper which they buy and other investments which they make. They are also called on frequently by their customers, their depositors, to give advice on investments. Ability to guide others safely requires not only a thorough knowledge of investment conditions, but a suitable system to preserve this knowledge.

Why
banks
should
have
credit de-
partments.

The credit department of banks is not so well established as the credit department of mercantile and manufacturing houses, but where such a department is established in large commercial banks, the work is as thoroughly differentiated and organized as in the credit

departments of either mercantile or manufacturing establishments.

Most banks with credit departments demand a property statement from prospective borrowers. The endorsement by the American Banker's Association and Association of State Bankers of the policy of requiring a property statement gave a sanction to this policy which many of the banks both within and without these associations had the wisdom to accept. The method of obtaining a property statement ordinarily differs from the method employed by the credit department in a mercantile establishment. When a new candidate seeks credit in a bank, he is usually turned over to the credit man who, using a blank form, obtains answers from the applicant regarding his financial condition and his reasons for credit, etc., and then obtains his signature to his report. He usually is requested to call later for an answer. In the meantime the credit man learns what he can of the applicant personally, his business history, his business ability, his reputation in his community for honesty, etc., his habits and his moral character, and then gives or withholds credit depending upon what he learns.

The credit departments also obtain information on specially prepared blanks from other banks with whom the customer has dealings, from references given by the applicant for credit, from other business houses which have a knowledge of the credit standing of the candidate, and from mercantile agencies like those of Bradstreet and Dun. These credit departments often obtain property statements once a year showing the financial condition of

their borrowers. These are tabulated and comparative statements are made out covering several years. One question found in some of the property statements asking how often the accounts of the concern are audited and when they were audited the last time, is especially significant.

CHAPTER VIII

SOURCES OF CREDIT INFORMATION

MERCANTILE AGENCIES

THE mercantile agency is an institution organized to investigate the financial standing, the business character, and habits of business men. To put **What the agency does.** the matter briefly, it is a credit information bureau. There are two classes of agencies, the general agency and the special agency. Of the first class, the two conspicuous examples are the Bradstreet and Dun agencies. The special agency obtains credit information in a special line of business, as furniture, shoes, coal, etc. Because it specializes, it is more efficient than the general agency in procuring and distributing information of a detailed character.

The agency will be discussed here from three points of view:

1. The economic conditions which gave rise to it, and its development to meet the needs peculiar to the United States.
2. The methods of the agency—its organization to procure and distribute credit information.
3. The utility of the agency to the business world.

The mercantile agency did not exist before the crisis of 1837. The industrial area of the United States at

that time did not extend far into the West. Cincinnati was then the great western city of trade with a population in 1840 of 46,000. Chicago and St. Louis were small trading ports, the former having a population of 4,470, and the latter of 16,469. Prior to the crisis of 1837, the western and southern traders visited the jobbers and manufacturers of the East twice a year to make their purchases. After the seller had a few minutes' talk with a merchant, terms of credit were agreed upon which usually required payment for the goods upon the return of the merchant when he purchased again. The relations between the jobber and the western retailer, between seller and buyer, were personal ones. Credit was granted because the jobber had confidence in the honesty of the trader and in his ability to conduct a successful business. When a merchant started in business, if credit was desired, he took letters of recommendation from his fellow merchants to their jobbers in the eastern trading centers. If retailers lived remote from jobbing centers, their purchases were restricted to the few jobbers with whom they had established personal relations.

While the traders of the South and West continued to visit the jobbers of the East, the relations between the buyer and seller were very different from those we understand today to be purely business ones. The trips of the retailers to the houses in the cities were not only for business but for pleasure. When trade relations were established between the jobber and the re-

Industrial
conditions
responsi-
ble for the
agency.

Personal
relations
between
buyer and
seller.

tailer, the personal relations between them became of such a character that the retailer usually purchased exclusively of the jobber. The standards of business and personal honor then demanded fairness in prices and in quality of goods on the part of the jobber, and promptness in paying his debts as contracted on the part of the retailer. An element of shrewdness and a power of personal control were acquired by the city merchant in those days which the changed methods of buying and selling have made unnecessary now.

Nearly all the states and territories had insolvency and collection laws, but they were rarely enforced, as

Insol- eastern merchants seldom attempted to pros-
vency and ecute bankrupts in the West and South.
collection Many merchants, even as late as the '40's,
laws of claimed that it would be better if all the
states. collection laws of the states and territories
were abolished, as higher standards of honesty
and honor would be developed without them.

These earlier notions gradually changed. The jobber had but little definite information as to the standing of

Failure of those to whom he granted credit, and he
early frequently discovered that his confidence had
methods been misplaced. Especially during times of
of granting panics and depressions, he lost heavily by
credit. injudiciously granting credit. Some of the larger jobbing houses that could afford to do so sent out agents among their customers to make collections and to investigate their standing and the character of their business. The means of travel were slow and difficult,

and this method of learning the status of those seeking credit proved to be very expensive. At least all the small jobbing houses were denied this means of investigation. Such credit relations prevailed exclusively among business men to the close of the crisis of 1837. After the crisis had spent its force, and thousands of merchants had been retired from business, the granting of credit with little or no knowledge of the standing of those seeking it became a very serious problem to both the jobber and manufacturer. Then, too, as business relations began to extend over a larger area, a greater need was felt for information concerning the business standing of men continually seeking credit, which could be procured nowhere but in the home of the merchant. It was at this time and under such conditions that the mercantile agency arose.

The rise of the mercantile credit agency may be traced to the eagerness with which information kept by the credit man of a large jobbing house of New York was sought for by sellers. The credit man recorded in a book all the information he could collect over a series of years concerning the traders with the house. The house failed, but the information was preserved. Other houses knowing this sought out the credit man to get his information. He began to sell it, and in this act of his we have the origin of the first mercantile agency. Tappan & Co. was organized in 1841. In 1846 Benjamin Douglas was admitted to the company as a partner of Tappan. In 1854 Graham Dun became a partner of

Organiza-
tion of
agencies.

Douglas and the firm name was Douglas & Company. In 1860 Douglas withdrew, and since then the business has been conducted under the name of R. G. Dun & Co. The Bradstreet Company, the other leading agency, was organized in 1849. Mr. John M. Bradstreet, a lawyer of Cincinnati, had charge of a large insolvent estate and learned by this means a great deal of credit information concerning people in and near Cincinnati. He made arrangements with several New York houses which enabled him to sell his credit information to them. This led him to organize an institution which dealt exclusively in credit information. He was soon joined in the business by his son, and the name was changed. The more recent change of title was in 1876, when the firm was incorporated as the "Bradstreet Company." Other general agencies for a time attempted to compete with the Bradstreet and Dun companies, but they failed, and now these two companies have practically a monopoly of the general agency business.

The agency was organized at first primarily in the interest of the jobber. Customers from different states and territories came to him seeking credit. **Development of agencies.** There was great need for information on the changing conditions of the dealers. As jobbing houses were established in western centers, branch offices were opened to collect and disseminate information. By 1850, besides the offices at New York, Boston, and Baltimore, western offices had been established at Cincinnati, Louisville, and St. Louis. By 1857, seventeen offices, besides the central one in New York, had

opened in trading centers. Each office was supported by the trading community of which it was the center. The office in Boston had charge of the trading community of New England, the one in Charleston the community of South Carolina and Georgia, while the Ohio Valley was divided between the offices at Pittsburg, Cincinnati, and Louisville. All the branch offices were under the control of the central office in New York, and they were all governed by uniform rules.

It could not be expected that an institution which encroached upon the personal rights of the individual and pried into the business affairs of merchants would develop without opposition. It met with bitter opposition by retailers, and at first it was not generally endorsed by jobbers. While many of the jobbers accepted it at once as valuable to them and supported it, others looked upon it as an unnecessary institution, and some agreed with retailers that it was contrary to the spirit of free institutions. At first reports had to be based upon hearsay evidence in communities and upon records of deeds and mortgages. Only in exceptional cases could the merchant be induced to give his standing. This prejudice against the agency has been bitter to within the last generation. Only within the last twenty years has the agency been conceded the right to require a signed statement. Even now the signed statement is repeatedly refused; but merchants generally feel that it is to their interests to comply with the requests of the agencies in giving statements over their own signature. A right has been established here by private companies

to inquire into the business affairs of individuals, a condition which has been impossible in foreign countries. In no country other than the United States do the mercantile agencies go so far in investigations of private business. Elsewhere the rights of an inquisitorial character have been monopolized chiefly by the state.

An investigation of certain business conditions in the United States and abroad will reveal the causes of the difference. In older countries business relations are more fixed; they move in more definite channels, and are better understood. Private agencies exist in other countries, but their information on the credit worth of applicants for credit is not as complete as in the United States.

In Germany a credit reform association was organized in 1882 by manufacturers, merchants, bankers, and other business men, for the purpose of distributing confidential information regarding the standing of firms seeking credit, and of collecting delinquent debts. The information procured and disseminated, however, was based on the records of business men in their dealings with one another, and on what could be learned in a general way as to their financial standing. This association, though still in existence, is not highly efficient, because the opportunity of procuring statements from merchants over their own signature is denied it. Even the right to investigate their standing from government records is restricted. In the United States, on the other hand, records have always been open to the inspection of the public within reasonable limits.

The mercantile agency here grew out of our credit system under the peculiar conditions of the rapid extension of commerce in a new country. Commercial centers were springing up in the newly settled parts of the south and west, and new customers were continually appearing in eastern houses and asking for credit. Business firms in the early days had but a transient existence. Attachments to a community had but little force, and migration to locations where more enticing opportunities were presented, was frequent. Business, too, was much more speculative in its nature then than now. While great successes are not infrequent in new countries, the business death rate, too, is high. In older countries business connections are more fixed, and business methods assume a more conservative tone. The same firm name often prevails in a community for generations, and the character of the business is analogous to that of Tennyson's "Brook." While great successes are very infrequent and almost impossible, the business death-rate compared with new countries is low. With the constantly shifting changes in mercantile life in America in early days credit was freely extended. Under these conditions debtors are more inclined to permit inquiries regarding their business standing. The two periods which completely unsettled business relations were most responsible for the origin and growth of mercantile agencies. The origin of the institution is traced to the endeavor to restore commercial order from the bankrupt institutions

Why conditions in America were favorable for growth of agencies.

left in the wake of the crisis of 1837, and the period of its greatest prosperity followed the unsettled business relations created by the Civil War. It is at such times that the business houses appreciate most the need of such information as can be given by organized agencies.

Retailers finally saw many of the advantages which the agency conferred. While the close personal relations

*Value to
retailer.* between themselves and the city merchants gradually disappeared, this loss was compen-

sated for in other ways. As soon as the agencies published the standing of business men, it was unnecessary for them to confine their city trade to one or a few merchants. They took advantage of the competitive principle and purchased where the best bargains were to be had. When they became subscribers to the agency, they learned what merchants in the city had the best rating, and this influenced them in buying.

In local communities the merchant grants credit to those only in whose intention and ability to pay he has confidence. Before credit is given, a personal knowledge of the man is necessary. Bankers likewise acquire a personal knowledge of men before credit is given. With the jobber and manufacturer the case is different. Their customers are distributed over a wide area, they come in contact with them only occasionally, and consequently their facilities for knowing customers are more meager than those at the command of the banker and retailer.

To the jobber and manufacturer the service of the agency was seen to be invaluable so long as the reports were accurate. The larger houses which sent agents to investigate the standing of their customers, found that the system provided by the mercantile agency permitted them to secure their information more cheaply. They were notified as to who the reliable merchants were, and were warned against men without business standing and of bad financial habits. A merchant who found himself unable to pay his debts frequently moved to a community where he was unknown, secured credit, if possible, and began again. In keeping careful records the agency traced these men from state to state, creditors were notified, and either settlements were effected or credit was refused.

Value to
manufac-
turer and
jobber.

The honest merchant derives an advantage when the agency makes it impossible for the unworthy to receive credit, as he is freed from competition with undesirable competitors. The competition of the business pirate and of the incapable is dreaded by honest merchants. Those who purchase without paying for what they buy are most indifferent as to selling prices, and the competition of such men makes deep inroads into the trade of other merchants. The same can be said with equal certainty of the merchants without business capacity, whose chief aim is to have a large trade regardless of selling prices, and who sooner or later must go down in the competitive commercial battle. Through the continued inspection and observation of the work of

business men, a force is exerted which lifts the methods and ideals of business to a higher plane. Favorable reports are responsible for credit, and to credit is frequently due business success. The agency contributes one of its chief services in working out a selective process by which the weaker members of the mercantile community are eliminated, and the most capable are permitted to survive.

One of the rights acquired by the mercantile agency is to demand a signed statement of the merchant. This

Signed statement. demand is by no means universally complied with, but is gradually growing so that merchants are beginning to feel that a difference is made in their standing when they refuse to give it. It possesses a legal status, since false statements make the individual criminally liable for obtaining goods under false pretenses. On this account it is considered valuable to the grantor of credit, and is given with care by the merchant. Individual reports have been given all along when requested, and one of the chief services of the agency consists in doing this.

ORGANIZATION.

The agencies are organized under the control of central offices in New York. The country is divided into districts, and in each district is an office to be supported by the district and to have charge of the collection and the dissemination of information within the district. The R. G. Dun Co. has 223 such districts. In each district there

**Organiza-
tion of the
agencies.**

are usually many counties. The company has three classes of investigators: (1) the traveling reporters, who visit every locality at least twice a year, and (2) the local reporter, who usually resides in the county seat, and (3) an attorney, who also resides in the county seat. Both the traveling reporter and the local reporter serve an apprenticeship in the district office before they are employed as reporters. The attorney who is employed as reporter as a rule gives only a portion of his time to the work and makes emergency reports or reports of developments which the district office needs to know at once. He is also the advisory agent of both the traveling reporter and the local reporter.

In some cases the work is divided into the difficult and the less difficult tasks and the more experienced men are put on the hardest problems. In the larger cities the work is classified with respect to kinds of business, and reporters specialize on classes of work. There is a great advantage in this because where there are many lines of business a reporter is put on each line; as a result he becomes an expert in reporting on his particular class of business and his services are continued in that field for years.

Each district office often has a number of sub-offices in its territory. The number of sub-offices depends upon the size of the district and other conditions. From these sub-offices reporters are sent out over the territory of the sub-office to make investigations and reports.

Specialization in work.

Sub-offices.

Each of the two leading agencies has foreign offices in every civilized country. The number of these offices depends on the size of the country and the importance of its trade to the United States.

Organiza- The R. G. Dun Company has four offices in
foreign Mexico and one in all the leading cities of
offices. Europe. From these offices traveling reporters are sent out to collect trade information. While the office is managed by an American the traveling reporters are almost invariably natives of the countries where the offices are situated. The reports obtained abroad are not as complete as the reports secured from business men in the United States, nor is there any great degree of uniformity of reports of the different countries. The managements of foreign offices in each country study the habits, methods, and policies of business men especially with reference to credit and there obtain such information as will make their reports conform as nearly as possible to the American reports. The information collected at the foreign offices is primarily for the benefit of American exporters who are subscribers to the agency. Foreign business men, however, make some use of the special reports obtained by the foreign offices.

In the New York office are assembled all the reports made out both at home and abroad for both the Dun and Bradstreet agencies. The Chicago office is to a less extent a clearing house for reports.

Clearing In the Chicago office are collected all reports
house made out in the western part of the United
offices. States, Alaska and Mexico. There is an advantage in

having territorial clearing houses as any one in a given district desiring reports from other sections of the district can obtain them sooner than if he had to send to New York for them. For instance with the present plan a merchant in Minnesota desiring reports from New Mexico can send to Chicago for copies of them. Copies of reports are always made out, and any office can obtain reports from any district where its subscribers are interested. The Columbus office obtains reports from every county in Ohio outside of the counties where Cleveland and Cincinnati are situated, because its patrons are interested in reports from every county in the state outside of these two cities.

Information is secured directly from merchants and manufacturers, and they are asked to make a signed statement giving the status of their business, containing assets, liabilities, capital stock, encumbrances on property, etc. Form VI is the property statement form for corporations; Form VII is the property statement form for individuals and partnerships, used by the R. G.

Methods
of
securing
credit
informa-
tion.

Dun Co. The differences in the questionnaires of the two forms are due to the differences in organization and in responsibility of the two types of concerns. If the person should refuse to make a signed statement the information is reported orally. If he refuses to give any information at all, the investigator finds out what he can from public records and from people in the community. Whether a signed property statement is made or not the public records are always investigated to learn if

Statement as a Basis for Credit

MADE TO

R. G. DUN & CO.

O. S. 0007

(Name of Corporation) _____ (Business) _____

Location _____ County of _____ State of _____

Dated _____ 19 _____ From Inventory of _____ 19 _____

Date of Incorporation _____ Under Laws of _____

Authorized Capital Stock, \$ _____ No. of Shares _____ Par Value, \$ _____

Amount of Stock subscribed, \$ _____ Paid in, IN CASH, \$ _____

Amount paid in otherwise than in cash and how, \$ _____

Limit of indebtedness allowed, \$ _____

BONDED DEBT, \$ _____ Drawing Interest at _____ per cent.

Whom does the Corporation succeed? _____

NAMES OF OFFICERS.

President, _____

Vice-President, _____

Secretary, _____

Treasurer, _____

Superintendent or General Manager, _____

DIRECTORS.

FORM VI.

SOURCES OF CREDIT INFORMATION 149

(a. b. cont.)

ASSETS.						
Real Estate and buildings,						\$ _____
Machinery and plant,						_____
Stock on hand raw and finished,						_____
Bills receivable, at realizable value,						_____
Accounts receivable, considered good,						_____
Cash on hand and in bank,						_____
All other assets, exclusive of patent rights,						_____
Total Assets,						\$ _____
LIABILITIES.						
For merchandise, open account						\$ _____
Bills payable,						_____
For machinery,						_____
Mortgages on real estate,						_____
Debts secured by mortgage (or lien) on personality,						_____
For borrowed money, unsecured,						_____
All other liabilities, contingent and otherwise,						_____
Total Liabilities,						\$ _____
Amount of Assets over Liabilities,						\$ _____
INSURANCE ON MERCHANTISE, \$ _____						
ON BUILDINGS, MACHINERY AND PLANT \$ _____						
Yearly extent of business, \$ _____						

Signed by

Bank and other References: _____

ADDITIONAL REMARKS.

FORM VI.—(*Continued.*)

Statement as a Basis for Credit
MADE TO
R. G. DUN & CO.

Of the Financial Condition of _____
Location _____ *County of* _____ *State of* _____
From Inventory of _____ 190 _____ *Business* _____
Dated _____ 190 _____

ASSETS.	\$
Merchandise on hand and in transit,	\$
Outstandings, including bills receivable, open accounts, etc at realizable value, . . .	_____
Cash on hand and in bank,	_____
Other PERSONAL assets, consisting of _____	_____

Total available assets,	LIABILITIES.	\$
For merchandise not due,		\$ _____
For merchandise past due,		_____
Loans from bank,		_____
Loans other than from bank,		_____
Other obligations,		_____
Total liabilities,		\$ _____

REAL ESTATE: Describe, locate, and value separately, and in entire name, with

Ever burned out? If so, state circumstances of fire, _____

Give full name of all the partners, _____

References: {

By William M. Dunn, Member of firm

Editorial office: 601 University Avenue, Suite 300, Seattle, WA 98101-3143

Bank with -

FORM VII.

there are mortgages or other encumbrances on the property. The agency also learns what it can of the habits and managing ability of the manager of the business. It finds out whether he attends to business, what his reputation for integrity and promptness is, and whether or not he speculates outside of his business. Whenever any suits are brought against him or when a mortgage on his property is given, or when losses are sustained by fire, these facts are immediately reported by the local agent to the branch office, and the creditors of the merchant are notified. Regular reports are made twice a year.

All the information gathered is classified and filed in card cabinets with reference to counties and cities, the names of the firms represented being arranged alphabetically with reference to cities. Whenever an inquiry is made regarding a firm the number of the inquirer is placed on the firm card. If changes take place in the status of the firm, the inquirer can be informed at once.

The information is distributed to the trade through the quarterly reference books and special reports. Subscribers pay \$100 a year for the quarterlies, and for a certain number of special reports. When all the regular reports are received and many of the special reports, the rates are much greater. Some of the subscribers to the two leading companies pay as high as \$30,000 annually for the services rendered. Each subscriber is invited to submit a list of his customers in which he is interested. Some

Classifying and filing information.

Distribution of information.

submit names of all their customers, while others give no report at all. However, the names submitted include nearly all concerning whom subscribers desire specific reports. When a special report is desired, the information is usually wanted immediately by the subscriber. The information at hand is collected, and, as a rule, it is reported within a day. If there has been an important change in the work of the concern, so that an investigator must visit the manufacturer or merchant, sometimes several days are required to make the report.

In the quarterly reference books furnished the subscribers by the two agencies, business concerns are classified with reference to their capital rating and credit rating. Signs are used to indicate the ratings. Nearly 20 signs are used to

Quarterly reference books. indicate financial ability and about 10 to indicate credit standing. Many factors enter into the rating assigned a business man besides his financial responsibility. His promptness in paying, his business ability, his personal habits including his inclination to speculate outside of his business, his refusal to furnish a report to the investigators, etc., are all factors which must be taken into account in assigning him a rating. In these signs which designate credit ratings is condensed a great deal of information. They are used for purposes of convenience to subscribers to enable them to read at a glance the credit rating of those in whom they are interested. Then, too, without such a condensation of information the quarterly reference books would be too bulky to be usable.

Until about five years ago the agencies issued daily

sheets or reports to supplement the quarterly reference books. To take their place greater use is made of the special reports. The daily trade reports became bulky and inconvenient to use. When first issued they were intended to convey confidential information to subscribers, but instead of being so treated they fell into the hands of collectors and collecting agencies and were used by them with great regularity in furthering the interests of their business in preying on those whose credit standing was not strong. To protect the trader from the irresponsible collector and to guarantee that the information furnished should be used only by those for whom it was intended, the agencies abandoned issuing the daily reports and gave more attention to the preparation of special reports which were sent to subscribers. Credit men who at first objected to the discontinuance of the daily reports now find the special reports more satisfactory to them.

An exceedingly valuable service is rendered by the two agencies, through their magazines, in reporting business conditions. These weekly reports furnish far more valuable and reliable information on the status of business conditions, of trade and market conditions in every section of the country, than any publication dealing with similar subjects. With agents in every section of the United States, and even in foreign countries, the agencies occupy a strategic position for collecting and making public reliable information which enables business men to adjust their plans in conformity to changes

Discon-
tinuance
of daily
reports.

Maga-
zines of
the
agencies.

continually taking place in the business world. The fact that this is only an incidental feature of their business in no way lessens their value.

UTILITY OF THE AGENCIES

Recently there has been a great deal of criticism of the mercantile agencies by credit men and organizations of credit men. The formation of credit men's associations and exchange information bureaus, and the efforts of individual credit men to gather a class of information concerning solicitors of credit which is not furnished by the agencies, are evidences of the shortcomings of the mercantile agencies from the point of view of the credit man. Mr. Prendergast in his work "Credit and Its Uses" claims that "there is a distinct feeling that while the mercantile agency service is valuable, it is not indispensable. Many of them have come to the opinion now that this class of information is only secondary." However, after several years of experience with credit exchange bureaus the complaint is made that some of the members of the bureaus rely exclusively on the bureau for credit information instead of subscribing to mercantile agencies and having the two sources of information supplement each other.

The criticism of the agencies by credit men has led to a great improvement of their service in the last twelve or fifteen years. The National Association of Credit Men has a standing committee on mercantile agencies, and many of the local associations of credit men have such a com-

**Improve-
ment of
service of
agencies.**

mittee. These committees have cooperated with the mercantile agencies, the service of the latter has been improved, and a better understanding prevails between the mercantile agencies and credit men as a result of their cooperation.

The chief criticisms of the mercantile agencies are the following:

1. Reports of agencies are sometimes misleading since the failures of those who have a good standing with Dun and Bradstreet sometimes occur.
2. Special reports furnished are unsatisfactory on account of the delay in securing them.
3. They fail to furnish ledger information.
4. The reports are lacking in system and definiteness.
5. The reports lack in comprehensiveness, in detail, and in attention to essential elements.

Credit men and the agencies themselves are better informed as to the validity of these criticisms than the writer. A few observations, however, may be made with safety. Where several hundred thousand reports are made annually, covering all business conditions and every section of the country, it is to be expected that some errors will be made, and that some Houses will be declared to be in good standing which go into the bankruptcy court. When judged by this standard alone the percentage of such errors determines the efficiency of the agency.

Why
mistakes
are made.

That the agency is slow with its reports is only partly true. Much depends on the nature of the informa-

tion desired and the difficulty of obtaining it. No rules can be given specifying the time required for such a

Are agencies slow in making special reports? report. If the agency has all the information desired at hand the report can be furnished the same day that it is requested. If the information must be procured after the request for it is received it will take one or several days to make out the report—the time depending upon the difficulty of securing the desired information.

The agencies have failed to furnish ledger information and they claim that it is impossible for them to devise

Agencies cannot furnish ledger informa- a system to exchange ledger information. It has been suggested that the agencies furnish reports free to all who furnish the agency ledger information. Both agencies refuse to do this, claiming that as they are private

money making concerns it would be impossible for them to adopt this policy without eliminating in a measure the source of their profits.

The criticism that the reports of the agencies are lacking in uniformity of form and development has un-

The form of reports. doubtedly improved the character of the reports. However, the argument of credit men that a universal form of report should be adopted to facilitate the reading of reports by credit men, does not seem to be valid. Both agencies require their reporters to follow a topical order of development in making their reports. However, both agencies absolutely refuse to adopt a uniform form of report, a thing

which would dispense with the need of having the credit men read all of each report. They claim that their reports are made out in such a way as to require the entire reading of a report and that it is only by reading everything that is reported that the credit man can have an adequate idea of the credit situation of the applicant for credit. Reporters are given the greatest latitude to write their reports in such a way as will give a correct view of the standing of the business reported.

With reference to comprehensiveness, to detail, and to emphasis on essential elements improvements are being made by the agencies. Shortcomings of reports in these respects are due chiefly to the inefficiency of reporters. Agencies claim that they are demanding higher standards of efficiency of their reporters and that they are increasing the costs of their service in making their reports more complete.

The active competition between the two agencies and the organized interest in them and their criticism of them by credit men will greatly improve the service of the agencies. The business community has depended on these agencies so long that it is not likely that it can soon dispense with their services. It has become so well adapted to them that it is more inclined to look harshly upon their shortcomings than justly on their merits. Their real merits could never be appreciated unless it were possible to forego their services for a while. For only in this way could business be made to realize how much it depended upon them.

Value of
the
agencies.

CHAPTER IX

SOURCES OF CREDIT INFORMATION

GENERAL SOURCES

SALESMEN

ASIDE from the information obtained from the mercantile agency by the credit department it obtains a great deal of information from a variety of sources. **Traveling salesmen can give important credit information.** In many respects the traveling salesman occupies, by virtue of his work, a better position than any one else to obtain the kind of information which a credit department needs.

He visits every community where credit is granted to business men. He ought to be able to learn through his relations not only with the business man seeking credit, but from others in the community with whom he has relations of either a casual or a business character, something of the credit standing of those in the community in whom the credit department of the house is interested. In selling to the buyer he knows from his experience with him whether he is a successful purchaser or not. From frequent visits to his store he knows something about his stock of goods, the character of his trade, and the adaptation of his business to his trade. Aside from this, there are many incidental facts that determine success or failure with which the salesman is familiar.

In the United States the traveling salesman first appeared as a part of our mercantile system primarily as a credit man. Near the middle of the nineteenth century when jobbers and manufacturers of the East abandoned the policy of selling almost exclusively to traders who visited their houses, and went into the West after trade, they sent men into the new communities primarily because they were interested in knowing the credit worth of those to whom they wished to sell. These salesmen became at the very outset credit men and collectors as well as salesmen, and it was to render the service chiefly as credit men and as collectors that they were employed as salesmen. With the newer developments of our mercantile system the work of the salesmen and of that of the credit and collection departments have been separated. Through specialization the credit men and collectors have limited themselves exclusively to their lines of work, while the salesmen have become almost exclusively salesmen. In recent years the tendency is to bring the salesman back into the credit work again because it is believed that by virtue of his position he can be of material assistance to credit men.

The cooperation of the credit man and salesman is not as effective as successful business methods should require. The credit man should be an adviser of the traveling salesman, while the latter is in a position to provide the former with invaluable information. The nature of their work makes them radically different, and an altogether different type of man is developed in each position. The salesman's work compels him to

Character
of early
work of
salesman.

adapt himself to all classes of people. He is sympathetic and responsive, and his feelings are easily aroused by

Differ-
ences
between
the
salesman
and the
credit
man.

the woes of the merchant. His success in selling goods depends upon his personal relations with the merchant. He becomes accustomed to their points of view, and consequently often becomes more interested in his customers than in his employer. The credit man, on the other hand, is cold, reserved, and unsympathetic. He is not easily moved by the misfortunes of people. His judgment is influenced by no motives other than the financial success of his firm. The work of the credit man is to make adjustments. His is the last court of appeal. His function is to guide business into safe channels.

In the business world the work of these two men has been differentiated, because two very different types are demanded and consequently many believe that it is a great mistake to use a salesman as a credit man and to withdraw him to a certain extent from the line of work in which he is efficient into a line to which he is little adapted. For this reason many are inclined to believe not only that the salesman should not do credit work, but that his credit reports are practically worthless.

The interests of the two are in some ways diametrically opposed. The one is anxious to secure as large an amount of sales as is possible, because his salary is to a certain extent determined by sales. The other is anxious to secure a maximum of sales to reliable firms, or to put the matter in another way, a minimum of sales to question-

able firms. In most cases the credit man is a stockholder in the concern, and on this account has an additional interest in having as few unprofitable sales as possible.

If the services of the salesman were so rewarded that his total sales would not influence his salary, he would be more serviceable to the credit man. In reporting the character of the business, the type of the business man, the character of the community, the industrial conditions upon which the success of the merchant depends, etc., he can give the credit man facts that are invaluable. From his broader survey of facts, and from his experience in watching credits, the credit man can estimate with a high degree of accuracy the probability of the success of the merchant. In going over routes with salesmen, the credit man can guard the salesmen against certain customers and can direct them into profitable fields. Through the supplementary nature of the work of the credit man and the salesman, and on account of the complementary qualities in the men, they should be mutually helpful, and their cooperation should make business safe.

The salesman is sometimes employed in collecting debts, but in this he is usually a failure. The type of man required for selling goods is different from the type required for collecting accounts. Besides, there is a direct economic loss in diverting, even for a part of the time, the attention of a man from a field in which he is skilled into a field for which he is not fitted. The salesman's relations with merchants unfit him for collecting debts from them.

Salesman
as
collector.

MERCANTILE CREDIT
SALESMAN'S CREDIT REPORT

FAIRBANKS, MORSE & CO.
ST. LOUIS, MO.

(Member of The National Association of Credit Men)

One of these reports must be filled out by the salesman when taking order from customer or customers with whom we have had no previous dealings. Where it is possible to do so each and every question should be answered fully and intelligently. These reports are for the guidance of the Credit Department and when properly filled out are of material assistance in determining the propriety of extending credit. The salesman is requested to give all information on these forms and not enclose it in letter regarding the order as these reports are to be filed in our "Credit Folders."

Name _____

Address _____

Age _____

Business _____

How long engaged in _____

Banks with _____

Owns real estate _____

Incumbrances _____

Stock valued at \$ _____

Supposed net worth, \$ _____

Buys from _____

REMARKS: _____

FORM VIII.

Report to be filled out by salesmen when taking orders from new customers.

SOURCES OF CREDIT INFORMATION 163

L. ADLER, BROS. & Co., Inc.

Dear Sirs: In response to your request I submit the following information concerning

of

FULL NAME OF EACH PARTNER	NATIONALITY	AGE.	MARRIED.

The firm has been in business
since _____
Formerly were at _____
or clerked for _____
of _____

or (here state other antecedents) _____

Lines of Merchandise carried? _____

Your estimate of present value of stock? \$ _____ Condition of stock? _____

Do they do a cash or credit business? _____ Amount of annual sales? \$ _____

City or Country trade principally? _____

Location relative to business centre? _____

Local opinion as to habits? _____ Ability? _____ Expenses? _____

Is stock well insured? _____ For how much? \$ _____ Is firm thought making money? _____

Is the firm, or any member of it, engaged or interested in other ventures? _____

If so give particulars _____

Real Estate in own name, if any, consists of _____ houses, _____ vacant lots, _____ business stores and valued at \$ _____ (shares number) and mortgaged for \$ _____

of this real estate the following is used as homestead _____

and valued at \$ _____ and mortgaged for \$ _____

If they are just starting in business, what capital has the concern and in what shape? Cash, \$ _____
other Assets, \$ _____

Describe the other Assets _____

Buy principally from the following houses (give address):

Clothing _____

Hats and Caps _____

Mens' Furnishings _____

Other lines _____

Yours respectfully,

Salesman.

FORM IX.

To be used by salesmen when taking orders from new customers.

Inquiry blanks have been devised to simplify and make definite the work of the traveling salesman in fur-

Inquiry nishing credit information. These blanks rep-
blanks. resent extreme types. Blank VIII is a simple

type which calls for information giving the name of the firm, the kind of business, the length of time the business has run, the value of stock, the encumbrances on the property and the firm's bank—which information is to be obtained directly from the seeker for credit. Aside from this there is a blank space for information of a more general character, which the salesman may learn incidentally from the purchaser and from others in the community. This form has a fatal weakness in that a report of the insurance on the property and stock is not required; the amount and kind of this insurance are in many respects the most important factors to be taken into account by the credit man. Otherwise this form can be used to a great advantage, and it is difficult to see how its use would stand in the way of the success of the traveling man as a salesman. Form IX, to be used by the salesman, calls for this information and other information of a more detailed character. The nature of some of the information sought in this form is such that many purchasers would be unwilling to furnish the information to a salesman who is seeking to sell goods, and the salesman would be very much disinclined to use it on account of the danger of preventing a sale. Consequently it is believed that a more simple type of blank is best for the salesman to use, and the credit men can then depend

upon the wisdom of the salesman in securing other information of a detailed character from others than the purchaser himself.

ATTORNEYS

From the attorney in the community where the business house makes sales, the credit man obtains important information. Mr. Prendergast in *Credit and Its Uses* gives five reasons why an attorney is an excellent medium for the procurement of credit information: "First, the organization of his office makes it convenient for him to act as a collector and distributor of such information; second, a lawyer invariably has a large circle of acquaintances, both of a business and social character, and this acquaintance enables him to secure information in regard to the circumstances of people to better advantage than others whose connections are not so extended; third, a lawyer's duties afford him much private information in respect to people's affairs, a large percentage of which information he is at perfect liberty to utilize as credit material without in any sense disclosing professional secrets; fourth, his daily association with matters in litigation opens to him an ample field of information, a good part of which is hearsay, but a large portion of which may also have considerable foundation in fact, and this information of either class can be judiciously diffused for credit purposes; fifth, he is frequently called upon to act as a collector of claims against people or in behalf of clients in cases where

Attorneys give credit information.

accounts are of a disputed character. The information he acquires through association with this work is of vital interest to credit givers and no better class of information could be obtained.”¹

Attorneys themselves have frequently volunteered to furnish credit information to business houses because of the advantages that may accrue to them in the way of employment in case of litigation. For this reason they have made out attorneys lists, which manufacturing and jobbing houses may use in calling upon attorneys to furnish credit information in the community where they live. This volunteer service on the part of attorneys has, on the whole, proved unsatisfactory not only to the attorneys themselves but to the houses that use them for credit information. The attorneys learned that upon the whole they received relatively little benefit for the services which they rendered, and in many cases a great deal of service is rendered in furnishing the credit information for which no returns are received. Upon the other hand, business houses complain of the character of the service rendered by attorneys. They claim that the attorneys prepare reports which are superficial in character and not based upon facts which could be easily procured upon investigation. When the attorney receives no returns for his services, it is apparent that his services will be of an inferior character. To correct this, many business houses make a practice of sending a small fee,

¹ Page 163.

usually one dollar, to the attorney along with the credit blank which he is to fill. The fee furnished is intended to pay the expense of the service in making the report. In cases where a more thorough investigation is desired the business house sometimes pledges itself to make further compensation commensurate with the services rendered by the attorney.

Since commercial work has brought into existence a class of attorneys who specialize in this field almost exclusively, many attorneys have developed offices which should be, in the very nature of things, of great help to credit men. They have large cabinets where detailed information is filed concerning the daily routine of their business. Their contact with the business affairs of the community is such as enables them to know more definitely than any one else in the community the credit standing of the people. If he can make this information which he has in his possession useful to the credit man in an honorable way, this type of attorney can render a great deal of valuable service to credit men.

BANK REFERENCES

Banks are used in many countries by mercantile institutions as an important source of credit information. In their dealings with their customers and from the property statements which they receive, it is possible for them to furnish a great deal of valuable information to credit departments. Upon the whole they have refused to furnish to credit men important information which they

have. They have insisted that in the United States it is impossible for them to furnish the information which credit men desire without being false to their own clients and without injury to their own business. The credit information which credit departments receive from banking institutions is practically a negligible quantity.

TRAVELING CREDIT REPRESENTATIVES

Some of the most valuable credit information is obtained by oral investigation. By visiting the business house which is seeking credit the credit representative can learn either directly or indirectly very valuable information to serve as a basis of credit. For this reason large houses doing an exclusive credit business have employed traveling credit representatives who obtain much valuable credit information which guides them in granting credit. They cover the same territory as is covered by the traveling salesmen and they obtain their information by the use of a questionnaire which is filled out after a personal interview with the seeker for credit. This credit representative learns incidentally from his conversation with the buyer many subsidiary facts which are important in granting credit. He learns all he can from court records and from conversations with other men in the community. When he leaves the office to visit these men, he goes prepared with all the facts that the credit office can furnish as a preliminary to the making of an investigation. In some cases these traveling credit representatives examine the books of debtors and

SOURCES OF CREDIT INFORMATION 169

confer with them in detail on the management of their business. This is done only when the debtor's status is precarious, and when somewhat drastic methods must be pursued. In ordinary cases of credit investigation nothing of this sort could be done without the loss of customers.

CHAPTER X

SOURCES OF CREDIT INFORMATION

CREDIT EXCHANGE

A SYSTEM of credit exchange has developed in the last fifteen years as the most accurate and in many respects

The development of credit exchange in last fifteen years. the most important source of credit information. This system was the outgrowth of the organization of local associations of credit men. Local as yet in character, it is the most important factor in many communities in the granting of credit, and it promises to occupy

a more important place in the future in the system of credit giving. Business men are the only source of credit information. A knowledge of a man's credit or of what credit he ought to have must be sought in his experience, that is from those with whom he deals. Other factors of a subsidiary character, such as his environment, capital, habits, etc., must be noted. The Credit Exchange Bureau represents an attempt by business men to learn from each other about the credit standing of their customers. It is the outgrowth of an endeavor to obtain the most accurate information of this character from each other with the least effort and expense.

The information furnished by the Credit Exchange Bureau is chiefly from ledger experience, and this has been proved to be the most valuable information to the credit man. It is supplementary to and a corrective of data collected by mercantile and other agencies and does not supplant them. While the mercantile agency procures information on the past experience of a business man, his character, his habits, his ability, his environment to do business, the Credit Exchange Bureau limits itself chiefly to one source of information, ledger and trade experience. While no one would discount the value of the general character of the information procured by other sources as a basis of credit, the function performed by the Exchange Bureau is a different one.

Exchange
of ledger
informa-
tion.

The inadequacy of other classes of information was responsible for the development of the Credit Exchange Bureau. The age of the mercantile agency report and the method of procuring it are often arguments against it. Allowance must be made for the reports of salesmen since the buyer is often his friend. The local attorney or agent is a fellow townsman of the buyer and often his neighbor. Besides, the buyer who intends to defraud sellers, employs methods which usually delude all other agencies. A favored practice of such is to keep good accounts with a few houses, which are given as references, while goods are purchased from a large number with no intention of paying for them.

Value of
ledger in-
formation.

When the first attempts were made to exchange ledger information after the local credit men's associations were formed, credit men were skeptical about furnishing the desired facts. It was feared that they would give up valuable business information, that they would give their competitors an advantage, and that they would furnish information concerning their customers which they had no right to surrender. This general attitude of suspicion, which existed among business men years ago, prevented the organization of business men's associations of all sorts, and their cooperation for common ends. Where ledger information was exchanged it became an important factor in developing a friendly feeling between business men and in developing a cooperative spirit among them, which was utilized for other purposes.

Soon after some of the local credit men's associations were formed cooperative plans were adopted for exchanging information with reference to debtors.

With some of the associations the credit clearing house work of furnishing credit information became the prominent feature. In 1900 there were credit exchange systems in six cities: Detroit, New Orleans, Baltimore, Cincinnati, Sioux City, and Minneapolis.

The methods of these may be grouped into what may be termed the New Orleans and the Minneapolis systems.

In the former the reports of merchants cover three important items: (1) Orders that have been declined

for any reason; (2) merchants who are delinquent in their payments or are otherwise unsatisfactory customers; (3) "attorneys who disregard instructions, are slow in reporting or remitting collections, charge excessive fees, fail to answer letters of inquiry, or are otherwise derelict in their duty." Each member was given a blank upon which to fill out a report. Each was furnished with a number, so that it was unnecessary to sign a name to a report. So long as members complied with instructions the system was successful, but it broke down on account of their lack of interest.

The New
Orleans
system.

In the Minneapolis system members were required to bring to each meeting lists of those whose orders had been rejected and of those whose accounts had been placed for collection. The reports covered simply these two items. The reports were read in open meetings and comments were made. Each member had a number which he used in making his report. Individuals outside of the association who reported were assigned numbers, and lists were kept of them. With a key to reports each member could determine what house had made a particular report and then make an individual inquiry.

The
Minne-
apolis
system.

The commendable feature of the system consisted in its simplicity. The varying success of the different methods used by the local associations seems to demonstrate that no method can succeed which requires much labor to make it effective.

The simple exchange bureaus organized at first, either

developed into more comprehensive systems or else failed and gave way to thoroughly organized Credit Exchange

Two classes of bureaus to-day. Bureaus. These may be divided at present into two classes: 1. "A method by which ledger facts and other information are obtained through the representatives of credit departments. 2. A method of entering information upon forms provided for that purpose, these forms being afterward assembled and a compilation made of all the information acquired."¹

An office is established with suitable filing cases and a secretary placed in charge of it. In the first

The card index system. method a list is made out of all members of the bureau, and a number is assigned each one. This list is furnished all members of

the association so that when a reference is given by number it will be possible for those interested to use the list as a key and know at once the other members interested in a given case. Each member is required to furnish a list of his customers. A card is made out for each of these, and on the card is written the numbers of all those who sell to the purchaser.

When an inquiry is made concerning the standing of a customer of any of the members, the secretary looks through the filing case for the customer's card. As this contains the numbers of all those who have dealings with the purchasers, the numbers are sent to the inquirer. By examining his list or key, the inquirer knows who the others are who have dealings with his prospective pur-

¹ Prendergast: *Funds and Their Uses*, p. 207.

chaser. These he calls by telephone or he sends a messenger to make inquiries of them. The information furnished is oral but is taken from the books. Other information of a general character may also be obtained.

One of the commendable features of this method is its simplicity. An office that will do the work satisfactorily may be maintained at small expense. The one seeking information can secure it at once, and in a few hours he can have what he desires to know of his purchaser.

By the second method of credit interchange, written reports are furnished those wishing them. A list is made of all members of the bureau and a number is assigned each, the same as in the first method. Inquiry blanks are furnished those seeking information, and inquiries are made from them. If each member seeks information about a large number of his customers in course of time the Bureau will have nearly all the information its members desire.

The
credit re-
port
system.

Each morning the secretary of the Bureau assembles all the inquiry blanks received. Requests are then made for information from all members with whom the customer has had dealings. The blanks call for information on the credit standing, the amount owing, the amounts due, the methods of payment, etc. This information is compiled into a report and furnished the member desiring the information. In some bureaus a copy of each report is sent to all members. The organization of the office and its equipment are in no important respects different from that in the first method described.

The Committee on Mercantile Agencies and Credit

Cooperation of the National Association of Credit Men in 1910 sent questionnaires to all the local credit men's associations to learn to what extent the local associations had established credit exchange bureaus, to learn the methods used, and the extent to which dealings were carried on with those outside the associations. Replies from thirty having credit exchange bureaus were received.¹ Of these thirteen used the first method, the card index system, while seventeen used the second system, that of compiling information. Eleven of thirteen associations using the card index system were willing to exchange credit information with outsiders, while only four of the seventeen that compile credit information were willing to furnish information to outsiders. The card index system permits dealing with outsiders to a much greater extent than the other system, as in the latter system detailed information would have to be furnished non-members who contribute nothing to the support of the bureau. An exchange of information with those outside the bureau is frequently desirable, as is the case especially with such mercantile agencies as those of the Bradstreet Company and R. G. Dun and Company.

The system of compiling credit information has its limitations for another reason. Business houses are still very skeptical about furnishing accurate information, to be made relatively general with reference to classes of customers they are

¹ Bulletin National Association of Credit Men, July, 1910.

carrying who are heavily burdened with debt.¹ These customers are often seeking credit with other houses and if all the facts were known they might be denied credit. The failure to receive credit by such houses would often result in their insolvency, a condition detrimental to the house which is carrying them and which has furnished the damaging information.

Another obstacle in the way of the interchange of credit information consists in the unwillingness of large firms with thousands of customers to exchange information with business establishments having only a few customers. The larger house would rarely learn anything from the ledger experience of the smaller house, while it would be a perfect mine of information to the smaller business establishments and would be frequently used by them.

The Committee on Credit Cooperation of the National Association of Credit Men was created by an amendment to the constitution of that association providing for such a committee, passed at its annual meeting at New Orleans in 1910. Prior to this the work of credit cooperation came within the province of the Committee on Mercantile Agency Service and Credit Cooperation. It has been shown in the chapter on Mercantile Agency Service that this committee was one of the most active committees of the National Association of Credit Men, and that its chief interest consisted in promoting the exchange of credit information. Both it and its successor, the Committee on

Exchange
of ledger
infor-
ma-
tion by
those not
mem-
bers
of credit
ex-
change
bureaus.

¹ Prendergast: *Credit and Its Uses*, p. 211.

Credit Cooperation, have urged upon members of the National Association to exchange ledger information freely. As a result of this persistent campaign the number of inquiries received by some members of the association has increased to such an extent that they have been compelled to employ a clerk whose time is devoted exclusively to answering these inquiries. The unfairness of receiving ledger information without giving data in return and the danger of breaking down the system of exchanging ledger information by those not members of bureaus which are organized for this purpose, have induced the Credit Cooperation Committee to devise uniform blanks to be used by members of the National Association of Credit Men when seeking ledger information. When one member of the association wishes credit information with reference to one of his customers, it is but fair that he give the man who is to favor him with a reply the benefit of his own experience. It is, moreover, only by this method of mutual exchange that any results of far reaching importance can be secured.

At the meeting of the National Association of Credit Men held in Boston in June, 1912, the Committee on Credit Cooperation submitted as a part of its report seven rules which were to govern members of the National Association of Credit Men. These rules which were adopted are as follows:

"1. The blank adopted and recommended by the National Association of Credit Men for the making of inquiries always to be used.

"2. Each inquiry shall state the amount of the order and always indicate if first order.

"3. If the inquirer has had previous experience with the one inquired on, then the inquiry shall be accompanied by a statement of such experience. This encourages reciprocal interchanges of experience and views.

"4. Inquiries are not to be made except on orders actually in hand or on open account. If investigation is being made with a view to soliciting business or collecting an account, a letter explicitly stating this fact should accompany the inquiry.

"5. It is fundamental that all inquiries are to be treated confidentially, and under no circumstances divulged to the subject of the inquiry.

"6. All inquiries to be answered on the day received and by the credit man or manager if possible, so that the ledger experience and any additional information in his possession may be furnished.

"7. A compliance with these rules in this interchange of credit experience and information leads to accuracy, reciprocation, promptness and confidence. Their observance will mean a closer contact between the members of this Association, and be of great assistance in their credit investigations."

Other institutions than credit associations are engaged in credit cooperation. The following organizations¹ are doing in this line satisfactory work: The Jewelers' National Board of Trade, The National Association of Clothiers, The Electric Trade Association of

¹ Bulletin National Association of Credit Men, July, 1905.

the Pacific Coast, The Merchants' Credit Association of California, The Stationers' Board of Trade of New York, The Crockery Board of Trade of New York, The Lumbermen's Trade Association, The Glass Dealers' Protective Association, The Manufacturers' and Dealers' Protective Association and The New York Paint and Allied Traders' Association, etc. The work of these credit exchange bureaus is very satisfactory, and in many respects the best work of this sort is done by agencies in a certain trade.

Personal credit or credit to consumers is usually given with less system and wisdom than credit to other classes.

Credit exchange bureaus of retail merchants' associations. Many attempts are being made to systematize credit to consumers by merchants, who exchange credit information with each other on the credit standing of their customers. The best-developed plans of this class have been established by the retail merchants' associations of Columbus, Ohio, and Indianapolis, Indiana.

The credit system of the former was established September, 1911, and of the latter about five years ago. The members of the Columbus Association are sixty-five of the leading merchants of the city. A central office is maintained with suitable filing cases, and the secretary of the retail merchants' association has charge of the office. The card system is used for filing purposes and the information is private. Numbers are used to designate persons and a code is used in giving the standing of credit applicants. Each merchant reports all his credit cases, and a messenger

SOURCES OF CREDIT INFORMATION 181

goes out from the central office each day to collect all new information. Two girls are employed in a private office where the cabinets are placed, using telephones to furnish information, when it is requested, to the members of the association. Some of the merchants have private wires with the office. Whenever a buyer goes to a store of a member to make a purchase and asks for credit, if his credit standing is unknown, the merchant calls up the office, and the desired information is furnished at once by telephone. If more detailed credit information is desired than is possessed by the office, a credit investigator is sent out to procure all the information which is accessible. For the purpose of obtaining this kind of information, the office of the association has established relations with many of the banks, manufacturing institutions, and other employing agencies where the people of the city work. Information is obtained with reference to salaries, business prospects, habits of life, etc., of those who seek credit.

The initiation fee of the members of the Columbus Association is \$50, while the annual dues vary from \$100 to \$300 a year, the amount depending on the service rendered. The cost of maintaining the Credit Exchange Bureau is approximately \$5,000.

The success of this plan depends almost entirely upon the organizing ability, the initiative, and the persistence of the manager of the office, who is in each of the above cases the secretary of the retail merchants' association. In both cities the merchants feel that the maintenance of such an office is an excellent investment on

account of the amounts which may be saved by avoiding bad debts due to giving credit unwisely. Neither association, however, is prepared to prove approximately how much is saved in this manner, owing to many confusing factors in estimating losses. The plans pursued in both of these cities are workable in all large cities, provided the right kind of ability can be secured in managing the general office.

Retail grocers and retailers in other lines have credit exchange bureaus, of which the Retail Grocers' Exchange

**Retail
Grocers'
Credit
Exchange
Bureau.** Bureau of Columbus, Ohio, is typical. About 225 grocers of Columbus maintain a central office where records are kept of the credit standing of the customers of the members.

Each grocer sends a report to the office on the credit standing of his customers who are given credit. Whenever a new applicant for credit comes to a store, the clerk calls up the central office, obtains his credit record, and then withholds or gives credit, basing his decision upon the information he receives from the central office. The great obstacle in the way of an efficient credit exchange bureau is the difficulty of getting grocers to furnish to the office promptly complete and accurate reports of their credit customers. The grocers have been urged to withhold credit from all customers who owe debts until the debts have been paid, but it has been found impossible to enforce this provision.

The credit exchange bureau may be made most serviceable to all business establishments when it is made national in its scope. At present there is some

interchange of information between bureaus in the same territory, such as the Cincinnati, Columbus, and Youngstown bureaus in Ohio; but there is no definitely organized system for the exchange of credit information between bureaus not in the same territory.

Unfortunately mercantile credit is at present local and not national. Banking institutions are local units, each community depending on its own resources for funds. The local associations exchanging information should extend their scope and provide an exchange bureau, which would be a clearing house of information for all the United States. Then the Bureau would have valuable information for all classes of business men. Before this end can be consummated it will be necessary to have well organized bureaus of exchange in all sections of the United States. At present only a beginning has been made. Hundreds of communities have no credit men's associations at all and no exchange bureaus. All the trades, too, should be organized on a national basis. There is a business consciousness of kind among members of a trade, and a national organization can be perfected more easily than the organization of a National Exchange Bureau from the various local organizations representing diverse interests. The cooperation of both groups is necessary to a great Credit Exchange Bureau national in scope. When this is accomplished mercantile credit will no longer be local but national, and the funds of the whole country may be made available for carrying on the mercantile business in any community.

Credit
exchange
national in
scope.

CHAPTER XI

ADJUSTMENT BUREAUS

THE adjustment bureaus have developed within the last decade as credit institutions. When the National

**Origin of
adjust-
ment
bureaus
and their
aims.** Association of Credit Men first took formal notice of them at its Memphis meeting in 1905 by the appointment of a special Committee on Adjustment Bureaus, several local associations of credit men were conducting

adjustment bureaus. After making a thorough canvass of the work of the various adjustment bureaus then in existence, this committee in its report to the Baltimore meeting of the National Association of Credit Men held in 1906 set forth the fundamental aims and objects of these bureaus as follows:

“1. To investigate, upon request, the affairs of a debtor reported to be insolvent and adjust the estate, when possible without court proceedings.

“2. To secure capable and efficient receivers, appraisers or trustees when court proceedings are found to be necessary.

“3. To secure quick adjustment of all honest failures at the minimum cost and with the maximum dividend to creditors.

“4. To facilitate and economically secure extensions

or liquidations when upon investigation it is found to be to the best interests of all.

"5. To influence concerted action by the creditors for the benefit of all.

"6. To assist creditors to acquire for their own use the estate of failing or insolvent debtors, when mutually agreed upon.

"7. To prosecute or assist in the prosecution of the guilty party or parties where investigation discloses fraud or the intent to defraud."¹

The functions of the adjustment bureaus as above stated show quite clearly the conditions which gave rise to them. When a debtor was in failing circumstances there was usually an absence of concerted action on the part of creditors interested. The debtor's estate was frequently dissipated so that there was little or nothing to be divided when action was taken against him. When receivers, appraisers, and trustees were appointed, they were frequently incompetent and were often friends of the debtor and acted in his interests. When attorneys were appointed they often had an inadequate knowledge of commercial law, and as a rule made excessive charges for their services. In general there was an absence of concerted action by creditors to protect their own interests, to preserve the estates of worthy debtors, and to punish the fraudulent.

Conditions giving rise to adjustment bureaus.

The value of an adjustment bureau may be seen by contrasting its methods with the usual clumsy and expensive

¹ Bulletin National Association of Credit Men, July, 1906.

methods of procedure in closing an estate. The investigation of a failure ordinarily proceeds slowly. Where credit exchange bureaus do not exist, the business of a bankrupt may be in very bad condition before bankruptcy proceedings are begun. A fraudulent debtor may escape, or his assets may be wasted, or his books and other data may be missing. Absence of concerted action is frequently responsible for delay. Where the failure is not a fraudulent one, lack of harmony among creditors, and the haphazard methods of handling estates, lead to a compromise at a small percentage of the claims.

The ordinary method of closing estates is harmful to the debtor also. The debtor whose liabilities are relatively heavy is always in danger of having action taken against him by an over-zealous creditor. As long as creditors act independently there is always a temptation to hasty action and the dissipation of the estate through a multiplicity of suits and executions. As soon as action is taken by one, others follow in proceeding against the debtor's property, and an inventory is taken of it. Although the debtor's assets may exceed his liabilities, yet for want of sufficient funds to promptly pay his debts he may be forced into insolvency or bankruptcy. When bankruptcy has been thus precipitated the trustee is practically compelled to sell the stock at a discount as he sells it under the conditions of a forced sale and this together with the costs of closing estates leaves creditors less than their original claims.

Where the adjustment bureau exists if a member comes in possession of knowledge that one of his debtors is in failing circumstances, he must notify the secretary of his adjustment bureau at once. The latter calls a meeting of the creditors, who carefully canvas the situation. If there are many creditors, a committee of creditors is appointed with power to act, and the foreign creditors are notified. An adjuster is usually sent to secure a financial statement from the books of the debtor, and if necessary he takes an inventory of his property. The committee of creditors then acts with full knowledge of the debtor's condition, and grants the debtor an extension of time if the circumstances seem to warrant it. If it is desirable that a trustee be placed in charge, the debtor is asked to make an assignment to him, and if he refuses to do so, he is made an involuntary bankrupt. Appraisers will be selected who have a special knowledge of the business and know how to estimate the value of the bankrupt's property. If an assignment is made, experts or men trained in closing estates are employed. Men skilled in collecting accounts and in disposing of merchandise are appointed, with the result that the bankrupt's property is disposed of at the least possible loss. As will be shown later, the costs of closing bankrupt estates by adjustment bureaus are much less than by the ordinary methods. Only when it is absolutely necessary are debtors required to make assignments. Those with small as well as large accounts and the foreign as well as the local creditors, are all treated alike.

How es-
tates are
closed by
adjust-
ment
bureaus.

The plan of organization of adjustment bureaus varies, but all of them pursue practically the same methods.

Plan of organization. The active work of the bureau is in the hands of either the secretary, manager, or both. A firm of attorneys is usually retained, and their fees are definitely limited by the bureau.

When the bureau serves a creditor upon his request, he alone pays the expenses. When it serves all the creditors of a debtor, the expenses are divided among them. A creditor in a remote section of the country can get a bureau to take up the case of a debtor residing in its district, and then give no further attention to it. The bureau's attorneys on account of wide experience are usually experts in handling claims, and the creditor, wherever he resides, is assured superior ability in looking after his interests.

The question has been raised frequently in the annual conferences of the National Association of Credit Men as

Should adjustment bureaus collect accounts. to whether the adjustment bureaus should become in any sense collection agencies. Previous to 1912 some of the bureaus had made a practice of collecting claims, and much opposition had arisen against this policy. Those in favor of the bureau's undertaking this work claimed that in certain sections of the country it could perform the best service to its members by collecting accounts. Those opposed to this policy contended that the function of the bureau was to investigate a debtor's financial condition, and, where he was solvent but in failing circumstances, to preserve his business, if possible

from failure; to act as trustee of his estate, where his success was hopeless, to manage it economically, and to preserve as much of it as possible for distribution. It was further insisted that an association of credit men should keep itself free from commercialism and it should make it obvious to the critics of the Association that a credit men's association is not organized for the purpose of enforcing the payments of claims due to its members; and that if it is to carry out the ideals of the National Association of Credit Men, that of being an institution to serve the general purposes of credit men, it should keep itself free from the taint of commercialism, which would inevitably follow the collection of specific debts. It was finally decided at a conference of adjustment bureau managers held in Chicago in 1912, and at the National Conference of Credit Men of the same year, that the adjustment bureau should "not handle delinquent accounts for collection as bureaus, nor should the managers or commissioners of such bureaus handle such delinquent accounts in their official capacity."

The policy to be pursued with reference to the notification of creditors when a debtor's affairs are under consideration has often been a mooted question. Some favored the notification of those only who were members of adjustment bureaus, while others favored the notification of all creditors. Those in favor of the former policy insisted that creditors not members of any bureau might not be in sympathy with the work of the bureaus and consequently might give their claims into the hands of attorneys or

Notify
creditors.

collection agencies, a procedure which would thus in a measure defeat the ends of the bureau that had the matter in charge. It was definitely decided by the National Association of Credit Men at its annual conference in 1909 that if any creditor should be notified, all should be notified regardless of their membership in bureaus.

There are three methods of organization of adjustment bureaus: 1. "the corporate form, in which stockholders are limited to members of a local association, and the management is in the hands of a salaried employee; 2. the general corporate form, in some cases without the stockholding feature, with the management in the hands of an attorney employed on the fee basis, he at the same time being actively engaged in the general practice of the law; 3. the committee form of management, a committee composed of representative members handling each case on its own merits, engaging such assistance, legal and otherwise, as may be deemed necessary."¹

Three methods of organization.

It would seem that the work can be carried on more successfully by the first method, as a salaried employee of ability interested in the work of the association can give much more effective services than either an agent hired from without or a committee which must from time to time employ legal talent.

The relation between the National Association of Credit Men and the bureaus of the local associations

¹ Bulletin National Association of Credit Men, July, 1910, p. 510.

have all along been mooted questions. At the Chicago meeting of the National Association of Credit Men it was decided that the adjustment bureau of a city should be affiliated with the local association of its district to be recognized by the National Association of Credit Men.¹ It was further decided that a uniform style of name should be adopted by each adjustment bureau; viz., Adjustment Bureau of the _____ Association of Credit Men. The advisability of appointing an agent in the office of the National Association to have supervision of the local association was recommended. Opposition arose to too close a supervision of the local bureaus by the National Association, and it was finally concluded that the supervision should be general in character only and that each local bureau should be permitted to solve its own local problems.

**Relation
of
National
Associa-
tion of
Credit
Men to
bureaus.**

As a rule the charges of the bureau go to the treasury of the local Credit Men's Association, and become a fund to bear the expenses of the bureau. These charges are uniform to all members of the National Association of Credit Men and its affiliated branches and are not to exceed 10 per cent. of the amount to be distributed to creditors except for unusual services. In some local associations the fee is limited to 5 per cent. of the dividends for services as trustee, while a higher charge is made to outsiders.

**Income
from ad-
justment
bureaus.**

¹ Bulletin National Association Credit Men, July, 1907, p. 425.

In another association the adjustment bureau employs an auction house to handle the stocks of bankrupts. The

Use of auction house. The goods of the bankrupt are not sold in bulk at a sacrifice, as is usually the case, but are broken up in small lots and sold at retail, the

auction house handling the goods at 10 per cent. commission. In this way much more is realized on the stock. The adjustment bureau may fix a minimum price on the goods, and if this is not secured the auction house will purchase them, after which they are sold in the usual way. When this method is pursued creditors do not need to wait till the goods are sold but receive a portion of the sum due them at once; and later when the stock is disposed of, they receive the balance due them in the form of dividends after the agent receives his share.

The experience of all the associations which have adjustment bureaus shows that estates can be closed by

Experi- ence in the economic closing of estates. the bureau at a much lower cost than that required when they go through the regular bankruptcy proceedings. The Adjustment Bureau of the Los Angeles Credit Men's Association during the year 1909 received from estates \$460,140 and returned to creditors in dividends \$422,722, the average settlement being 55.85 per cent. The handling of half a dozen cases in which there were no assets reduced the average percentage returned to creditors. In 1908 the dividends returned to creditors were over 60 per cent. of the liabilities.¹ The Chicago Adjustment Bureau

¹ Bulletin National Association of Credit Men, March, 1910, p. 141.

returned to creditors over 60 per cent. of the liabilities of insolvency cases at the end of the first six months of 1909. In 1909 the Spokane Bureau¹ received in claims \$275,000 and paid to creditors 58.8 per cent. of their claims. The Denver Adjustment Bureau,² the first to be organized, made its seventh annual report October 1, 1910, and the expenses on adjustment were 2.9 per cent. of the funds collected. The report shows that twenty-nine cases were handled, and the creditors received 41.3 per cent. on liabilities. All creditors, whether local or foreign, whether members of the association or not, receive the same attention, as it is the policy of the Denver Bureau to place all claims on an equal basis. The bureau's success has been such that during the eight years of its existence but little business has been turned over to the bankruptcy court in its territory. The reports of the various bureaus show that in insolvency cases creditors receive from 30 to 60 per cent. of their claims, whereas in insolvency cases handled by other agencies creditors receive far less—amounts not exceeding on the average 25 per cent. of the liabilities. The adjustment bureaus accomplish this saving by selling goods at greater advantage, by a better system of collecting book accounts, by eliminating the excessive charges of attorneys, trustees, etc., and by a prompt settlement of estates. However, a number of these adjustment bureaus charge membership fees which help to

¹ Bulletin National Association of Credit Men, March, 1911, p. 166.

² Bulletin National Association of Credit Men, February, 1910, p. 107.

defray the expenses of the bureaus. Where the adjustment bureau is operated in conjunction with a credit exchange bureau, as is the case in thirty-four of the forty-four adjustment bureaus, a great force is exerted to prevent failures by forcing settlements before estates get into a desperate condition.

Adjustment bureaus are widely distributed throughout the country but are more numerous relatively in the West.

Distribu- There are twenty-two bureaus on each side **bureaus.** of the Mississippi river.¹ Of those east of the Mississippi river, nine are south of Mason and Dixon's line, eight are in the Middle West north of the Ohio river, and five are in the Middle Atlantic States. Of the five in the Middle Atlantic States, Pennsylvania has four and New York one.

The special committee on adjustment bureaus of the National Association of Credit Men made an extensive

Confer- report on adjustment bureaus at the annual **ences of** meeting at Philadelphia in 1906. Beginning **adjust-** with the 1907 annual meeting, the Adjustment **bureau** Bureau Committee has been a standing com- **managers.** mittee of the National Association of Credit

Men and one of the very active committees of that body. Since then there has been an annual meeting of the officers of the adjustment bureaus of the country, the first one meeting in Cleveland, Ohio, in 1907 and the last one meeting in Chicago, Ill., in January, 1913.

¹ Bulletin National Association of Credit Men, July, 1912, p. 592.

At the Chicago conference of adjustment bureau managers in 1912, the following "rules and principles of conduct for adjustment bureaus connected with affiliated branches of the National Association of Credit Men" were adopted. As these were also adopted by the National Association of Credit Men at its conference held in Boston in June, 1912, they represent a late development in adjustment bureau policy and method.

"1. The adjustment bureau to be established by and under the absolute control of the local association of credit men. If the local association is incorporated, it may be optional with that association whether the adjustment bureau be separately incorporated. If the local association is not incorporated, it is suggested that the adjustment bureau be separately incorporated and governed by a board of directors selected by the local association; if not incorporated, governed by a committee appointed by the local association.

Rules of
associa-
tions.

"2. Adjustment bureaus are primarily established for the benefit and service of the members of the National Association of Credit Men and its affiliated branches for the saving of expense in administering solvent and insolvent estates in which they may be interested; but such bureaus shall not handle delinquent accounts for collection as bureaus, nor are the managers or commissioners of such bureaus to handle such delinquent accounts in their official capacity.

"3. A delinquent account within the meaning of Rule 2 is one that is considered uncollectable upon present

demand, and is not placed for the purpose of investigation or adjustment.

"4. The adjustment bureau is to be operated by a manager or commissioner selected by the governing committee or board of directors.

"5. Each adjustment bureau shall have an adjuster, who may be the manager, commissioner, or one of his assistants. He shall make investigations at the request of any member of the association at a compensation not to exceed \$15 per diem and expenses.

"6. In the absence of other agreement, should the adjuster discover upon investigation that the affairs of a debtor or debtors need general adjustment, then the adjustment bureau which the adjuster represents shall, without further instructions, proceed to the adjustment of the debtor or debtors' affairs for the benefit of all creditors; in which event, the expenses of the investigation shall be pro rated against all claims handled by such bureau, unless otherwise provided for.

"7. If the estate to be adjusted or liquidated is located in a city where an adjustment bureau is located, and where there are other creditors of the estate in interest, there shall be cooperation between the bureau where the estate is located and the originating bureau; but if the estate is not located in such city, then the adjustment is to be made under the supervision of the bureau where the adjustment originated.

"8. The manager or commissioner of the adjustment bureau where the investigation or adjustment originated is to advise immediately the managers or commissioners

of all adjustment bureaus where creditors are located, and also all creditors. He shall also suggest to the creditors that it is preferable that claims be forwarded through the local adjustment bureau, or that creditors can forward claims direct. The local bureaus shall be kept fully advised by the operating bureau of the progress of the case.

"9. An allowance not exceeding one-third of the commissions charged on claims is to be allowed the bureau on such claims as are forwarded by that bureau or sent direct.

"10. The adjustment bureaus are formed not to make a profit, but for economical administration for the benefit of those interested—therefore all charges shall be reasonable, the schedule of charges adopted by each adjustment bureau to be filed with the national office, and with the chairman of the Adjustment Bureau Committee.

"11. A committee consisting of the chairman of the National Adjustment Bureau Committee, and one member thereof, two adjustment bureau managers, and the secretary-treasurer of the national association, shall constitute a committee of complaint to arbitrate all complaints between adjustment bureaus or between members and bureaus, and the decision of a majority of such committee shall be binding upon all parties in interest, and such decision filed with the national association's committee.

"12. Reports, at least quarterly, shall be furnished the national office of the estates adjusted in each of the local adjustment bureaus."

The adjustment bureau managers at their recent conference in Chicago, January, 1913, took a decided stand for uniformity in operating adjustment bureaus. It was contended, however, that as some bureaus had been organized for years it would be inadvisable to attempt to enforce a uniform operating plan, but that uniformity and a high standard of bureau efficiency could be gradually secured by a system of cooperative supervision. To carry out this program it was recommended "that the country be divided into seven zones, and that in each zone there be appointed a committee of not less than three nor more than five whose functions it will be to have the direct oversight of the bureaus in each zone, to investigate complaints, to arbitrate disputes, and to bring about a cooperation of the work in each zone. These committees should be appointed by the National Committee on Adjustment Bureaus and the National Secretary and Treasurer subject to the approval of the national president. The committees should be responsible to the National Board." The adjustment bureau managers recommended further that every local association of credit men should organize an adjustment bureau upon plans approved by three committees, the zone committee, the national committee on adjustment bureaus, and the advisory committee of the board of directors on adjustment bureaus. It was moreover recommended that no new bureau should be organized without the approval of the above named committees, and that the zone committee should withdraw its official sanction from any bureau which was not properly conducted.

The report of the adjustment bureau managers will be submitted to the National Association of Credit Men this year for adoption. This report represents the latest development in adjustment bureau work. It is believed that the supervision proposed, if put in practice, will enable the bureaus in each territory to work in better harmony, to standardize their methods, and to do a much higher grade of work than has been done heretofore.

CHAPTER XII

COLLECTIONS

As the success of a credit department depends in great measure upon its collection service, every thor-

Relation of collections to the credit department.oughly developed credit department has a well-organized division of the department, or an adjunct to the department, devoted to the collection of accounts. The work of granting credit is completed only with the

collection of the accounts created by the credit department. Whether this work falls within the province of the credit man, his subordinates, or some allied department, the collection service should be closely related to the credit department, as the efficiency of the latter is measured by success in making collections. The purpose of the credit department is to prevent losses, and if accounts are not collected the credit department is a failure.

The kind of ability needed to make collections is often different from the qualifications demanded for a

Qualifications of a collector. credit man. The manager of collections must be a good judge of human nature, and he should possess the diplomacy which will

enable him to handle successfully the great variety of credit cases with which he must deal. The classes of creditors determine largely the policy to be

pursued. The most desirable creditors require but little effort to make collections. However, if a business were limited alone to these, a strong credit department would be unnecessary and but little cost would be entailed in making collections. Under present day competitive conditions credit must be extended to all classes, to the doubtful as well as to the safe credit risks; and the manager of collections must have as varied qualifications, although of a different kind, as the credit man himself.

All are agreed that the first essential to successful collections is to call for payment when an account is due. No debtor can object to being called upon to carry out his agreement to pay a debt, and in general debtors are inclined to pay promptly when called on to do so. Moreover, carelessness in collecting tends to develop habits which demoralize debtors and make collections difficult.

As most collections are made by mail, a system which will enable the collection office to take up promptly and to handle properly all accounts is necessary to every large business which deals extensively in credits. Various systems of card indices are in use. A common method is to place each credit account on a separate card. The card has blank spaces for the name, rating, address, terms, date of invoice, the amount of debt and when the account is due. Some cards have also blank spaces to indicate when a draft is made out for collection and when it is returned, to give the comment of the debtor and a record of the

Prompt
collections.

Office
system to
follow col-
lections.

final disposition of the account. These cards are kept in a tickler and so arranged that the one who has charge of collections can turn at once to the cards having records of accounts due on a certain day. If for certain reasons the collection of some of these accounts is to be postponed to later dates, the proper entries are made on the cards, and they are placed with others which are due on the same designated dates. By this system all the accounts may be properly handled when due, and with little effort the one who has charge of collections may know when and in what order the accounts of a business become due.

While this system is advantageous to most businesses, in many, especially the smaller concerns, the one who has charge of collections relies on the information he can obtain directly from the ledger from day to day. Others depend on their memory or on note-book memoranda and consult the ledger when other methods fail. While the keeping of credit reference and collection cards takes time, this work can be done by subordinates; and as the tickler may be placed on the desk of the one who has charge of collections, the information he desires is at hand on a moment's notice. If he depends on his ledger for information he must often go into an adjoining room to consult it, and while he fails to economize his own time he disturbs the work of the bookkeeper or accountant.

In the retail business the practice is general of making collections the first of each month by rendering state-

ments to debtors. Of all accounts these are perhaps the easiest to collect. Consumers as a class receive credit with the expectation of paying their bills by checks the first of each month, and retailers grant credit under the assumption that payments will be made promptly at the close of the month. Many of the latter prefer to have payments made in this way rather than by cash. Most of the accounts rendered are itemized, and after the account is returned to the seller accompanied by a check it is again returned to the purchaser, receipted. When goods are delivered, an itemized statement is usually sent with the package.

Retail
methods
of
collecting
accounts.

Instead of sending accounts by mail some firms employ collectors to visit debtors to make collections. These collectors present a statement of the account to the debtor, and if the latter pays at once either in cash or by check, the collector receipts the bill in the name of the firm and gives it to the debtor. Whatever advantages this system may give to the business houses that employ collectors, debtors prefer to receive statements of accounts through the mail and to pay by check.

Accounts may be divided into (1) live and (2) tardy accounts. A live account is one which is just due, or one which is not yet due, while a tardy account is, as its name implies, one that is over due. It is the latter class of accounts which receives attention in any consideration of the subject of collections.

Two
classes of
accounts.

The consideration of live accounts is important because if they receive adequate attention much less effort will be necessary to collect tardy accounts.

Live accounts. When an account is due it should be collected

promptly unless there is a good reason for granting further time to the debtor. However, before an account matures the creditor should know how his debtor is treating other accounts, for slowness in making payments is the first danger signal. If the debtor is slow in paying other accounts, the creditor has every reason to believe that he will be slow in paying his account, and business failures are almost invariably preceded by a period of tardiness in paying debts.

When a debtor is slow in making payments, the creditor should investigate at once the causes of his tardiness.

Causes of delay in paying. Of the various factors responsible for business trouble the debtor himself is directly responsible for some of them, while others arise from causes over which he has no control. To act wisely the creditor should have a correct interpretation of the situation. While creditors must count on debtors paying their obligations, the embarrassed debtor must rely on the assistance of merchants who will sell to him if he is ever to recover from his embarrassment. At this point the creditor has an opportunity for the exercise of superior judgment. Many worthy debtors have been made bankrupts by the rash actions of their creditors in collecting accounts, who if leniency had been shown, could have recovered and become prosperous. Upon the other hand, through the free

granting of credit and through the failure to make collections promptly, many debtors have developed habits of slow payment and loose habits of business in other respects, which have resulted in insolvency.

As soon as accounts are due debtors receive statements of the account with request for payment. It is chiefly to obviate the failure to present claims for payment when due that systems of collection are devised. However, few would advocate the following of the same system or the same routine in all cases when debtors fail to pay at maturity. A system planned with the view of treating all debtors alike is a faulty system. Differences in customs and practices of different trades and businesses and differences in personality, must be regarded especially in the initial stages of tardy accounts. Before more drastic methods are pursued such as the sending of drafts for collection, putting accounts in the hands of collectors, personal letters are usually sent to debtors inquiring why the payment is not made and urging that the debt be paid promptly. If the customer is a desirable one, care is taken not to lose his trade by offending him. If drastic action must be taken, it is usually assumed that the customer is lost to the creditor.

Perhaps the most common way of making collections from delinquent debtors is by the draft. The sending of a statement to a debtor when his account matures is the first step taken to collect a debt. The use of a draft to collect is ordinarily the next step. The time which elapses between the sending of a

First
method of
collecting.

The draft.

statement and a draft varies with the business practices. Some mail a draft at once as soon as the creditor learns that a check did not come by return mail. This is, however, unusual, as creditors ordinarily make allowances for delays and some even go so far as to exhaust all other means in the way of sending statements repeatedly and accompanying their statements with letters to the debtor, before a draft is sent for collection.

When a draft is used it is either given to a local banker to be sent by him to a bank for collection in the community where the debtor is engaged in business, or it is sent directly by the creditor to a bank in the debtor's city. If it is sent by the latter method, a letter of instruction is usually enclosed with the draft in which the banker is directed to collect at once and remit the proceeds or to return the draft giving reasons why the debtor refused to pay. At the time the draft with the letter is sent to the banker, a communication is usually sent to the debtor, telling him that a draft for a given amount has been placed in the hands of a banker, and directing him to pay the debt to the banker. If the draft is placed in the hands of the creditor's bank, the latter sends the draft with instructions to a bank in a community where the debtor lives, and this bank notifies the debtor that a draft has been placed there for purposes of collection. When collections are made, banks deduct a small fee for the service rendered before sending the funds to the creditor. When collections are not made, banks do not receive fees for the service they render only in the exceptional cases where creditors mail a small fee

with the draft to pay bankers for their service whether payment is made or not.

The collection agency draft system was devised by collection agencies to facilitate the collection of small amounts by drafts. To these drafts are attached stubs directing banks to place the drafts in the hands of attorneys named on the stubs, in case payment is not made to the bank. This method has the merit of showing the debtor as soon as it is presented to him that if he fails to make payment the draft will be placed immediately in the hands of an attorney for collection. Most debtors are thus coerced into paying, not desiring to be confronted with the action of an attorney to collect the debt. However, the system has its demerits on account of the drastic action which is threatened. The credit of debtors suffers in the minds of bankers when they observe the extremes to which creditors are inclined to go to collect their debts. It may be safely stated that in many cases where these collection agency drafts are used the credit of debtors does not warrant the depreciation caused by the use of these drafts.

When debtors fail to pay drafts when presented, the next step is to use the collection letter. At first a mild letter is written requesting payment, and after this each succeeding letter demanding payment becomes stronger. At present a series of collection letters is prepared by collection agencies in the order named and sold to creditors. When these letters are sent to debtors they are accompanied

The col-
lection
agency
draft
system.

Collection
letter.

by envelopes having printed on them the names of the collection agency, and they consequently impress debtors with the idea that they have been placed in the hands of an outside agency for collection. Many debtors respond more quickly in making payments on this account. This is the psychology of the collection letter.

Many systems of collection letters are used. Trade organizations used the collection letter before it was produced and sold by private agencies to creditors. These are used now by many trade organizations, and also by some credit men's associations. One system requires members who use the collection letters to notify the agency or collection bureau of the progress in collecting an account, and if payment is not made it takes active charge of the account. The collection letter is ordinarily used only when the future trade of the debtor is not considered a matter of importance and no care is taken to avoid offending him.

After all other means have been exhausted the attorney is resorted to as the last resource in making collections.

Attorneys as collectors. When an attorney is called in it is usually decided to enforce the collection of the account.

The policy of resorting to this method varies widely. Some resort to a method of enforcement soon after an account becomes delinquent, while others defer such drastic action as long as it is possible to do so. The costs entailed by the employment of an attorney are one reason for deferring this action.

When an attorney must be employed to collect an

account, there is often some question as to whether the debt can be collected or at least collected in full. This tends to make the creditor hesitate. The attorney must usually content himself with collecting the debt on the installment plan, else he must bring legal action to enforce a payment. Ordinarily, creditors prefer the partial payment plan if the debt will be paid in full to the legal action plan, in which the costs of collection will be greater, and in which there will be some risk of not receiving the payment of the debt in full.

To facilitate the employment of suitable attorneys in a community at a distance from the place of business of the creditor, attorneys' lists are furnished by publishing companies. These are responsible companies with reputations to maintain, and they endorse the attorneys on their published lists. Some of these companies guarantee to their subscribers the accounts collected by the attorneys on their lists. In these cases the lists are known as "bonded lists" and the attorneys as "bonded attorneys." Some of these companies, as a condition of being held responsible for the amount the bonded attorney collects, require the subscriber to report at once the employment of such an attorney.

Some large firms doing an extensive credit business make their own lists of attorneys who are employed in adjusting their accounts. They prefer to investigate themselves the standing and character of all the attorneys they employ in the various communities where they do a credit business. This method is possible only with large firms. Some do not employ local attorneys but

send their own attorneys to communities where their services are needed. The advantage of the latter system is that the business house has full knowledge of the man who is entrusted in making collections. By the latter method there is some disadvantage in unfamiliarity with local conditions, and in some instances in an increased cost in collecting debts.

CHAPTER XIII

MERCANTILE CREDITS AND DEPRESSIONS

IT will be the aim of this chapter to trace the influence of one force—mercantile credits—upon depressions and crises. MacLeod states the purpose of credit “to be the temporary advance or creation of capital, to promote an operation which is expected to repay the capital employed in its promotion, as well as certain profits, within a defined period.”¹ From this statement of the purposes of credit it will be seen that it is connected with business transactions which are more or less speculative in character, and when credit is created that cannot be sustained, commercial houses fail. Commercial relations are so interwoven and commercial factors are so interdependent that one great failure may bring about a multitude of others, with losses of sufficient proportion to precipitate a crisis.

Mercantile institutions are at the present time so organized that it is impossible to do business on a cash basis. The question as to whether a cash is better than a credit system is not pertinent so long as we have not learned to buy and sell for cash. Our present credit system has developed as a part of our present industrial

Mercantile
credit.

¹ MacLeod: Theory and Practice of Banking, p. 252.

organization, and it is futile to discuss how things would be if our industrial system were different.

Mercantile credit consists in the advancement of goods or commodities for a stipulated period, with the understanding that the seller has a right of action against the purchaser at the expiration of this period. Mercantile credit is granted when the seller believes that the purchaser will be able to pay at the expiration of the term of credit. The theory underlying mercantile credit is that the buyer will pay for the goods advanced from the proceeds of their sale; and the term of credit is in theory the period required to sell the goods and realize on them. When the goods are of such a character that a long time is required to sell and to realize on them, then a long term of credit prevails.

In distribution, goods may pass through the hands of the following distributors:

1. The grower or importer.
2. The manufacturer.
3. The wholesaler or jobber.
4. The retailer.
5. The consumer.

The first four of these use goods as capital, and the fifth must pay an amount for them adequate to cover the original cost and the profits of all the distributing factors. As business is now organized it is impossible for each of these factors to advance the capital necessary to carry on its function and wait until it is rewarded from the profits of its investment. The manufacturer must invest in a

Channels
of distri-
bution.

plant and then wait a considerable length of time until the product is produced, sold, and paid for, before he realizes on his investment. The wholesaler buys from the manufacturer or grower and sells to the retailer, but realizes nothing upon the capital invested in the goods until they are sold; if the goods are sold on time, which is often the case, he must wait often several months before the goods are paid for. The retailer buys of the wholesaler and realizes nothing until his goods are bought and are paid for by the consumer. These distributors either must have capital to conduct their business until the product is sold, or else have capital advanced until they realize on their sales. By having the capital advanced temporarily they greatly extend their business. It is to perform this function that banks of discount have developed.

A credit may be recorded as a simple book account, as a bill of exchange, as a promissory note, etc. A creditor may secure an advancement of capital upon a debt expressed in the last named form. The manufacturer who sells goods to the wholesaler on time accepts a promissory note from him, and with this he secures an advancement of capital from his banker by selling the note. The wholesaler is then under obligation to the manufacturer's banker for the payment of the note, but in event of failure to pay, the manufacturer is responsible. The wholesaler may sell the same goods to a retailer on time and receive a promissory note from the latter for the amount. The wholesaler has this discounted by his banker, to

Methods
of giving
mercantile
credit.

whom the retailer must pay the debt at the expiration of the term of credit. In the exceptional cases where the consumers give notes, the retailer may sell to the consumer, accept his note and have it discounted at bank, where the consumer must pay the debt when due. Two persons are responsible for the payment of each of these notes. For the payment of the note discounted by the manufacturer's banker, both the wholesaler and manufacturer are responsible; for the payment of the note discounted by the wholesaler's banker, the retailer and wholesaler are responsible; while for the payment of the note sold to the retailer's banker, both the consumer and retailer are responsible.

It is usually assumed that it is perfectly safe to advance money upon notes which are to be paid from the sale of goods, as there is real property in existence to be used for the payment of the notes. In the above assumed case, however, money is advanced in purchasing notes to the extent of approximately three times the value of the sales; or if we omit the loan of the retailer, as the instance is an exceptional one, money is advanced to twice the amount of the sales. The price paid by the consumer for the goods must cover the entire costs, together with the profits of the distributors. The failure of the wholesaler, retailer or consumer to pay might make it impossible for all of them to pay, in which case at least two of the bankers would lose to nearly twice the value of the goods. In the case assumed three bankers advanced capital, each to the extent of a particular sale. In an industrial center frequently a banker

advances capital to the manufacturer, wholesaler and retailer for the sale of the same goods. In event of failure in these cases the burden of losses is more concentrated. Our confidence in the security of these loans is quickly dispelled when we reflect that there is often twice as much money in outstanding notes as there is property to represent it. These observations will at least go to show that the advancement of capital by bankers must be based upon the honesty, integrity, and business sagacity of borrowers rather than upon the character of the individual transaction upon which the capital is advanced. In times of normal prosperity the likelihood of loss to the bank is not great, as two persons are pledged to the payment of each note. Of course, in case of a collapse of a business house, losses are likely to fall on the bank with which the house deals, as it is extremely improbable that all its obligations are so secured that no losses to the bank result. With the collapse of a business house, others are certain to be caught in the ruin, and then the general security of these houses alone prevents a disastrous reaction upon the business community.

MERCHANTS who conduct a safe business are compelled to keep funds on hand to tide them over emergencies when they rise. A wholesaler usually sells largely on credit, and when his debtors fail to meet their obligations at maturity, if he possesses no surplus capital, he becomes unable to meet his own obligations and is confronted with bankruptcy. Trading up to the limit of one's means, or trading without

Over-trading.

holding in one's possession a sufficient amount of capital to tide over emergencies, is overtrading. When his debtors fail to meet their obligations, the wholesaler is often forced to have his bills or notes discounted even when the rates charged are exorbitant. With him there are but two options, high interest rates or bankruptcy. When the financial condition of a merchant becomes precarious, his banker, as a means of self-preservation, becomes conservative. It is often within his power to save or ruin the merchant. He may save himself by permitting the merchant to be ruined, or if he grants credit to a merchant who has over-traded, he himself runs the risk of being involved in the ruin of the merchant. A happy set of circumstances may so prevail that a merchant may over-trade for years without suffering loss. However, losses may come to him which will cause his ruin through (1) unfortunate business accidents of debtors, (2) granting credit to unworthy business men, and (3) general reverses in business conditions.

The statistics of banking and commercial failures during the last thirty years furnish a very instructive object lesson on the general causes of failures. **Influence of rising and falling prices on credit.** During periods of rising prices credit is freely sought and as freely granted. The incentive to realize wide margins leads traders to extend their credit as far as possible and to make the utmost use of their capital. While prices are rising and trade is brisk, the wholesaler orders freely from the manufacturer and enlarges his stock with the hope that larger margins may be realized by still higher

prices on the goods purchased. The retailer orders freely from the wholesaler with a similar motive. Under these conditions the manufacturers' plants are taxed to the fullest capacity to meet the demands made upon them. Finally, when the output of certain classes of goods exceeds the real demands for them, the upward movement of prices is stopped, and a scramble among dealers begins in order that they may get rid of their goods before they begin to decline. This vigorous competition to dispose of stock leads to a further decline in prices, and mercantile houses that have indulged in over-trading go to the wall. Under these conditions houses that purchase large stocks on credit, with a view to selling on wide margins, often find that the profits from sales are inadequate to pay the original costs, and that failures are certain to result unless emergency funds are at hand. It takes but a few failures to react on other houses which likewise have over-traded, and finally a general ruin of business institutions takes place.

A condition of rising prices, of general business prosperity, preceded the panic of 1893. During 1892 trade was very brisk. But few plants were idle.

Wholesalers stocked up freely and retailers, to get the advantage of wide margins, also purchased extensively. Unfortunately, at such times traders are not so careful to adapt their supply to the demands of trade, and when the reaction sets in a great deal of unsalable stock is left to tell its story of speculation in the production and in the sale of goods. Distributors are more careless in granting credit in pros-

A cause of
the crisis
of 1893.

perous times than in other times, and when the reaction sets in the ruin is more complete. When the reverses came in 1893, only the institutions which exercised great discrimination in granting credit, and those which carefully guarded against over-trading, weathered the storm in safety.

The years of 1898 and 1899, which were noted as the period of recovery from the crisis of the preceding years, illustrate clearly the phenomena above described. The year 1899 stood out conspicuously as one of prosperity. It was a year of generally rising prices. Plants were running to their fullest capacity, many of them both night and day. Demands were brisk in nearly all lines and wholesalers and retailers competed vigorously in purchasing large stocks of goods to get the advantages of the wide margins which are always inevitable at times of rising prices. At such times few fail. As a consequence, in spite of our enormous increase in business institutions, fewer failures with smaller losses were recorded in 1899 than in any year since 1881. In the early part of 1900 the upward movement of prices was stopped. Institutions which had over-traded and had given credit carelessly were ruined. There were 1,437 more failures in 1900 than in 1899, and the liabilities aggregated \$47,615,784 more than in 1899. Because of the enlargement of operations in building there had been considerable speculation in building materials, and with a decline in price, many dealers in lumber and machinery failed. If the price reaction had been more general, the failures of 1900 would have been more wide reaching.

Dun's Review has furnished a summary of the number of failures, with the liabilities of the bankrupts for each year since 1856. It is difficult to draw any conclusions as to the percentage and amount of failures from decade to decade from these figures, as an accurate account cannot be taken of the increase in wealth. However, for short periods the fluctuations in the number and amount of failures are very instructive. The amount of failures in 1857 was enormous. For each of the next three years the failures amounted to less than one-third those of 1857. Then in 1861 the failures attained enormous proportions. During the remainder of the war and for a few years following, the statistics of failures do not include the Southern States. In 1873 the failures amounted to over \$200,000,000. In 1874 there was a decline of nearly \$50,000,000. Then for the next three years there was an increase in failures, the maximum being reached in 1878. A reaction with fewer failures took place in 1879. Prosperity, as expressed in few failures, continued for several years. Since then, as before, few failures have occurred during periods of rising and many during times of falling prices.

Commercial failures are inseparably connected with credit giving. The frequency and the enormity of failures are traceable to the extent and freedom of granting credit. The influence of changes in distributive industry upon credit and failures remains to be considered. When credits are long and transfers are frequent, a great number of accounts that represent

Number
and extent
of failures.

the same property may be created, and where this is true the probabilities of failure are increased.

During recent years forces have been at work not only to lessen the number of distributive factors but to put

**Changes
in organ-
ization of
mercantile
insti-
tutions.** transactions more nearly on a cash basis. Under the old distributive system, products passed through the hands of the grower, the manufacturer, the jobber and the retailer before they came into the possession of the consumer.

Where goods were imported the number of distributing factors was greater still. While these distributing agents still remain, they are not so important as formerly. The department store, the mail order house, the branch store, the cooperative purchasing combines, and institutions which organize the means of distribution in connection with manufacturing, all lessen the distributing agents and hence lessen the extent of credit created for the purpose of disposing of goods. In lessening the amount of credit given they make failures less likely. One of the reasons for the existence of these institutions which organize the distributing factors is to put buying more nearly on a cash basis; hence less credit is required. The indirect influence of these institutions has a remote yet positive effect on credit giving. The competitive influence of these institutions tends to lower margins realized by distributing factors. Retail dealers generally are very much inclined to say that margins are so narrow that they must discount their bills if adequate profits are realized. Wholesalers are practically forced to take the same

position. In order to conduct a profitable business it becomes necessary for them to have a sufficient capital to tide them over from the time goods are purchased until they realize on their sales. Hence the tendency in the organization of distributive business to drive down the margins of the distributing factors is resulting in lessening credit.

Other forces have been at work in the United States, which increase the liability to failure and also the amount of credit giving. When insolvency occurs, merchandise is a quick asset, at current value, to the extent that it conforms to the staple type. Articles like cotton, leather, iron, rubber, sugar, coffee, tea, etc., upon which but little labor has been devoted, can be turned into cash much more quickly and with less loss than the more highly worked-up manufactured products, (which may be classified under the head of specialties or novelties). New countries manufacture only the cruder kinds of articles. It requires generations to develop skill in working up the more highly developed textile products, and it has been only recently that the United States has been taking an important rank in this line of manufacture. The statistics of textile manufactures in the United States from 1850 to the present time show how rapidly this line of manufactures has grown. So long as we depended on foreign trade for textile products, trade in them was more nearly on a cash basis. With a decrease in the importation of this class of goods and an increase

Change in
the
character
of com-
modities
produced.

in production of them at home, trade in them has been converted very largely from a cash to a credit basis. So long as home production was confined to commodities closely approaching the staple type and credit was created for the purpose of moving them when a merchant became insolvent, his assets were quite readily convertible at current rates. But when the commodities of a merchant are largely specialized and are the result of a great deal of skill, or are produced to satisfy the demands of fashion, then in event of bankruptcy the losses incident to the forced sale of such goods are enormous. Hence much depends upon the class of goods manufactured at home in influencing the frequency and extent of failures.

Since we have been producing to a large extent the more highly worked-up textile products, dating ahead
Dating ahead. has been introduced and it is invariably associated with the giving of credit. When goods are sold dated ahead, the term of credit does not begin until after the expiration of the dating. Manufacturers often sell goods before they are produced, and jobbers sell them before they have possession of them. The payment is considered a cash payment if the goods are paid for at the expiration of the time of dating, although the goods may be delivered at that time or some time in advance of the period at which they are dated. Dating ahead not only actually prolongs the time of credit but it indirectly leads to its extension. As all extensions of credit increase failures, the practice of dating ahead may be considered one of the causes of failures. There is, however, one mitigating circumstance connected with

the influence of dating ahead on insolvency. The lack of adaptation of production to consumption is more strikingly seen with specialties than with necessities. In dating ahead the adaptation is shifted from the producer to the retailer, who stands close to the consumer and is better acquainted with his wants. Hence dating ahead on this account tends to decrease the losses due to misapplied production. However, this economy is made less effective owing to carelessness in purchasing by retailers, carelessness that is due to the considerable length of time which may be allowed to elapse between the time when goods are ordered and when they may be paid for under the system of dating ahead. This is due to the psychological instinct which makes people more careless in purchasing when the time of payment is postponed.

All these factors must be taken into account in considering the influences which operated in the crisis of 1893 as distinct from the earlier ones in the United States. The census statistics for 1890 as compared with those of 1880 show a wonderful transition during that decade from industries devoted mainly to the production of raw products to those of manufacture. During the decade the population increased 25 per cent. The agricultural population, however, increased but 10 per cent., whereas those engaged in manufacture increased 49 per cent. and those in mining 49.3 per cent. The number of acres devoted to wheat production during the decade decreased 5 per cent., while the corn acreage increased but 15 per cent. The statistics of country and city population show an increase in the town and city population at the ex-

pense of that of the country. The decade was marked by a very large increase in the raw materials used in manufacture, whereas the figures on textile production show a rate of increase twice as great as the increase in population. The great increase of this class of products was marked by falling prices, with the usual evil consequences to distributing agents. This increase, the increase in credit transactions which accompanies dealings in textile goods, and the unsettling of normal business relations caused by important changes in industry are more responsible for the crisis of 1893 than is usually attributed to them.

It is perhaps safe to say that the work of the national and local credit men's associations, the work of credit exchange bureaus, the improved efficiency of mercantile agencies, the introduction of system in business and especially in credit, and the production on definite orders, more than counterbalance the weakness of the credit system resulting from a prolongation of credit through dating ahead, and also that coming from the influence of the production of highly specialized commodities. Consequently, business ruin as a result of credit giving will be less complete than formerly.

CHAPTER XIV

CREDIT MEN'S ASSOCIATION

I. HISTORY OF THE NATIONAL ASSOCIATION OF CREDIT MEN

THE Credit Men's Association can be traced to a Commercial Congress held at Chicago at the World's Fair in 1893. One section of this Congress, which was presided over by P. R. Earling of Chicago, was devoted to the subject of credits. The chief paper presented, entitled "The Value of Signed Statements," was read by Mr. W. H. Preston of Sioux City, Iowa, who has since been prominently identified with both national and local associations of credit men. Only a small number took an interest in the association, but a committee was appointed to consider the advisability of organizing a national association. On account of the crisis which followed, it was thought a very inopportune time to organize a National Association of Credit Men, and the matter was delayed. Finally in 1896, after several local organizations of credit men had been formed, arrangements were made for a national association to meet in Toledo, Ohio.

Opposition to the National Association came from three sources: (1) Mercantile agencies feared that it

might constitute itself into a reporting agency which would displace them, or that it would demand from them better service than they could afford to give. (2) Attorneys feared that it would put them at a disadvantage in regulating fees, etc. (3) Retailers feared that it might be oppressive to them.

The purpose of the National Association was well stated in Article II of the Constitution: "The object of the organization shall be the organization of individual credit men and associations of credit men to make more uniform the basis upon which credit rests; to demand a change of laws unfavorable to honest debtors and the enactment of laws beneficial to commerce in the several states; to improve methods of diffusing information and of gathering data with respect to credits; to improve business customs; and to provide a fund for the protection of members against injustice and fraud."

The membership was divided into two classes: (1) The organized membership, to consist of credit men representing individuals, firms, or corporations, who may join through the medium of local associations; (2) the individual memberships, to consist of credit men representing individuals, firms or corporations, who may join the association directly. The latter are from sections of the country where no local association exists. In communities where there are local associations affiliated with the National Association, the members of the local asso-

ciation represent it in the National Association. The organized membership thus includes the membership of all the local associations affiliated with the national organization. At the Toledo meeting in 1896 it was estimated that the volume of trade represented by those present amounted to \$213,000,000. The growth of the association is indicated from the following facts. The organized membership in 1900 was 2,511; the individual membership was 490, making a total of 3,001. This was an increase of 465 over the membership of the previous year. On the first of June, 1904, the organized membership was 4,528, and the individual 799, making a total of 5,327.¹ On the first of June, 1905, the organized membership was 5,085 and the individual 976, making a total of 6,060, or an increase of 557 of the organized and 177 of the individual membership over that of the preceding year. In June, 1906, there were fifty-two local associations that were affiliated with branches of the national organization. Every section of the country is represented. The association meets annually, and the work is carried on chiefly by committees.

The scope of the work is indicated by the names of the standing committees: Membership Committee, Legislative Committee, Business Literature Committee, Committee on Improvement of Mercantile Agency Service, Committee on Credit Department Methods, Committee on Credit Cooperation, Committee on Adjustment Bureaus, Committee

Com-
mittees.

¹ Monthly Bulletin of the National Association of Credit Men, July, 1905, p. 24.

on Investigation and Prosecution, Committee on Fire Insurance, Committee on Bankruptcy Law, Committee on Banking and Currency, Committee on Uniform Exemption Laws, Committee on Uniformity of State Laws, on Federal Incorporation Laws, and on Commercial Arbitration.

From the outset the National Association and the local associations undertook the same kind of work. To

Differen-
tiation of
work of
national
and local
associa-
tions. interchange information in regard to credit, to make credit men more intelligent, and to improve legislation in the interest of credit men, were the early objects sought. Gradually plans were devised to place the organization on a broader basis, and new standing committees were organized.

Some of the local associations saw that their effectiveness would be increased and enthusiasm for them promoted by their undertaking practical work, such as the organization of adjustment bureaus and bureaus for the exchange of credit information. The National Association has come to see that it must be organized on a broader plan, and that as a recent president of its organization has said, "It must stand for the general improvement of credit conditions, act as a cement force between its various local organizations devoted to the ethical phases of credit, and act as an educational center of economic problems."¹ Although its work and that of the local associations overlap somewhat at present, the tendency is for each local association

¹ F. W. Standart: Monthly Bulletin of the National Association of Credit Men, January, 1905, p. 7.

to undertake the decidedly practical work and to consider the problems of credit peculiar to its locality. The National Association is limiting itself more and more to the general problems of credit. It aims to supplement and to coordinate the work of the local associations and to cooperate with them on general problems such as those of legislation. There is still a Committee of the National Association on Investigations and Prosecution, but its experience seems to demonstrate that this sort of work can be better conducted by local associations where they exist. Here, as elsewhere, the National Association finds its chief efficiency in securing the cooperation of the various local bureaus rather than in undertaking this sort of work itself.

The most effective committees have been the following: Committee on Improvement of Mercantile Agency Service, Committee on Credit Department Methods, and the Legislative Committee.

From the outset the credit men manifested a desire to cooperate with the agencies in inducing merchants to make better reports. From the beginning, the National Association considered as one of the chief topics the inadequacy of the agency reports, with the result that at some of the earlier meetings, representatives of the Dun and Bradstreet agencies were present to defend their methods. It was urged that signed statements should be secured from the merchant in all instances when possible, and that if the latter refused and the information had to be secured otherwise, this fact

Work of
Com-
mittee on
Mercan-
tile
Agency
Service.

should be indicated in the report of the agency. It was asserted that agencies ought to have efficient reportorial staffs who were experts in dealing with business men and in reporting business conditions; that a search of records ought to be made in every instance, and that no indefinite reports should be given; that all ratings should be revised at least every six months; and that new information should be furnished promptly on request; that all statements should be carefully tabulated. It was urged that a large number of the reports were written by men in various communities, usually by lawyers, who relied largely on hearsay evidence, and that the reports in no way indicated the sources of information. It was maintained that reports, especially in country districts, were inaccurate and that special reports were received tardily. In all cases where a regular reportorial staff was collecting information, it was said to consist of an inferior set of men; and it was believed that much of the antipathy of business men for the agencies and the inadequacy of information was due to a lack of tact and diplomacy on the part of the reporters of the agencies.

The agencies looked upon the claims of the credit men as ideal and visionary. The latter were informed that the carrying out of the recommendations here suggested would involve a very great expense, and that the receipts of the agencies would not warrant the undertaking of the improvements suggested.

The agitation in favor of a higher standard had an immediate effect in improving the efficiency of the agencies. The President of the Bradstreet agency claimed

that in 1898 his company expended \$150,000 more than in former years in improving the service and it was said that extra expenses were incurred by the Dun agency for the same purpose. According to these agencies their reports were secured by a more efficient set of men, were better arranged and more promptly rendered.

The Mercantile Agency Committee has compiled statistics on the comparative efficiency of the Dun and Bradstreet companies, covering in general the following points: (1) Average time between asking for reports and receiving them; (2) average age of the first report received; (3) percentage of reports containing signed statements not more than one year old; (4) the promptness of reporting changes; (5) arrangement and form; (6) classification of reports according to excellency by districts. These data were furnished by the local associations and the members of the National Association. When these facts were first published they at once showed the comparative efficiency of the leading agencies and at once a vigorous rivalry was created. So long as no method exists to show definitely the comparative merits of rivals, vigorous competition will be lacking; whereas the fixing of a definite standard for determining superiority stimulates efforts to excel as nothing else can.

The credit men claim that the suggestions made to the mercantile agencies have received consideration and that the service of the agencies has improved in every way. The feature complained of most frequently at present is the lack of accuracy in the detailed reports. One of

the resolutions presented at the 1905 meeting and passed unanimously, was "That R. G. Dun & Co. and the Bradstreet Co. be requested to discontinue in their reports the expression, 'He is the reported owner of real estate,' etc. The ownership of real property is a matter not of supposition but of fact, and therefore easily determined; and we have a right to expect that they will search the county records and establish the facts as to whether the real estate referred to stands on record in the name of the reputed owner or some one else." This resolution indicates the feeling of the credit men regarding certain classes of the reports of mercantile agencies.

The Mercantile Agency Committee has endeavored to secure signed statements from merchants upon uniform blank sheets made out by the committee. To this end it has endeavored to prevail upon the agencies to use its signed statements, but so far its efforts have been unsuccessful. Although the agencies have modified the form of the blanks formerly used, they have been unwilling to adopt those suggested by the credit men. As stated above the signed statement has many features to commend it. Although statements rendered in writing may be inaccurate, they are as a rule, much more truthful than verbal reports. The necessity of making a signed statement leads merchants to know their business more accurately and to keep better books. A signed statement has a legal significance. The merchant who makes a signed statement does so with a view to secure credit. If his statement is manifestly false, his offense comes under the head of securing goods under false pretenses,

and the offender is criminally liable. So in all cases where preferences are allowed and the bankrupt has made some signed statements, the advice of his attorney is, invariably, that he shall take care of such creditors first.

It is well known that different localities have different classes of agency service. Everything depends on the efficiency of the man having charge of the territory. In some places the service of one agency is far superior to that of the other, and in other localities there verse is true. A resolution providing for the continuance of the investigation of the relative merits of the two agencies, and also for an investigation of localities where each is deficient, was passed at the June meeting, 1905. Form X shows the method of investigation by the committee.

Like other private concerns the agencies are of course interested in profits, and this is kept in mind in the introduction of improvements in service. That the service rendered is not all that is desired by business houses is seen in the tendency of large wholesale and banking houses to employ experts whose exclusive duty it is to investigate customers affairs and to study conditions which directly influence credits. In doing this they are limiting their agency service and are depending more and more on their own agents. In this development we see a tendency to return to conditions which existed prior to the organization of the agency service. How far this tendency will go remains to be seen.

The Committee on Credit Department Methods has labored from the outset to secure the adoption of uniform in-

quiry blanks and statement blanks. At the first meeting, forms were proposed and sent out to the various local

**Work of
Com-
mittee on
Credit
Depart-
ment
Methods.** associations to be topics for discussion at the meetings in 1897. Forms were adopted at the convention of 1898 which provided for giving the creditor a clear idea of the standing of debtors and were sufficiently binding as to make the debtor criminally liable in case of false statement. Much is gained in the adoption of a single form or report. Merchants are not confused by having different kinds of reports to make out; they know what to expect, and the binding nature of the report becomes generally known.

At present the Committee on Credit Department Methods manufactures several forms of property statement blanks, several short payment forms, a trade inquiry blank, and unjust discount stickers. These are sold to members and others. The unjust discount sticker may be pasted on a letter. It contains this statement: "Discount for cash is a premium for prompt payment within the time and upon the terms as agreed, and when not earned should not be claimed. Please add to your next remittance \$....."¹

It soon became apparent that in order to have uniformity in bankruptcy legislation, it was necessary to secure the passage of a national law instead of trying to bring about uniformity through the cooperation of the various state legislatures. No matter what the skill with which

¹ Monthly Bulletin of the National Association of Credit Men, June, 1905 pp. 35, 36.

NOTE.—This record is PRIVATE. The only data to be furnished in the annual return are the TOTALS.

No.	NAME	TOWN	STATE	BRADSTREET					DUN					Report with reference to the same period as above, but not more than one year earlier.	Report with reference to the same period as above, but not more than one year earlier.
				Date of Applia- tion to B. S.	Date of first re- port	Number of enquiry- ings	Age of enquiry- ing in days at time of first report	Per- cent of enquiry- ings which have been paid within one year	Report with reference to the same period as above, but not more than one year earlier.	Date of first report	Number of enquiry- ings	Age of enquiry- ing in days at time of first report	Per- cent of enquiry- ings which have been paid within one year		
Amounts carried forward.															
1															
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25															

Amounts carried forward.

state laws were drafted, state legislatures could always be relied upon to modify the laws sufficiently to make the legislation of the various states diverse.

On this account the National Association of Credit Men, as well as most of the local associations, vigorously supported the original Torry bill when it was before Congress, and later the law which was passed in 1898. The Legislative committee has been very aggressive in proposing changes in the law, and the amendments which have been passed were chiefly due to the work of this committee. During this time, however, the interest of the legislative committee in procuring reforms in state legislation has never ceased.

The National Committee usually works in cooperation with the state associations to secure local legislation. In all instances where bad laws are on the statute books, cases are introduced to test their constitutionality. In 1896 the New Orleans Association, with the consent of the National Association, took charge of all legislative questions in Alabama, Arkansas, Texas, Georgia, the Carolinas, Mississippi, Florida, and Louisiana. Two laws were passed by the Louisiana Legislature in 1896. The laws introduced in Alabama and Arkansas were passed in 1899. The chief reforms in state legislation prevented the sale of goods in bulk, and prevented preferences.

When the Lodge Bill concerning the consular service was before Congress, the Legislative Committee of the Na-

Association instrumental in causing Bankruptcy Act to be passed.

Cooperation of national and local associations in having state laws passed.

tional Association labored in its interest. The association at its June meeting passed a resolution favoring the adoption of this law or another containing some of its provisions. The prominent provisions advocated were an improved classification and grading, the substitution of salaries for fees, an increase of salaries, the application of the merit system, efficiency as a test for continuance in office, the Americanization of the service, and the requirement that consuls must be familiar with either the French, German, Spanish or Chinese languages, and "possess a knowledge of the natural, industrial, and commercial resources of the United States."

The variations in the provisions of the homestead and exemption laws of the various states have caused an endless amount of confusion and annoyance to commercial interests. The National Association at its meeting in 1905 resolved to engage in a campaign of education to make possible more uniform laws. It was recommended that the local associations make this subject a feature of special interest in the following year. The National Association, through the Legislative committee, began an investigation of these laws with a view to printing them to show their lack of uniformity.

Other matters which engaged the attention of the Legislative Committee were (1) the making criminal the mailing of a fraudulent statement concerning one's financial condition with intent to defraud by securing through it goods or money, and (2) the enactment of laws designed

to regulate the carrying on of business under an assumed or fictitious name.

Nearly all the laws of recent years providing for better relations between creditors and debtors may be traced to credit men's associations. In a number of notable instances these organizations have failed to accomplish their objects. However, their power is growing. Statements made by Ex-president Fessenden of the New York Credit Men's Association, in an address before that organization in 1899, are very significant for that date. "To-day we are recognized," said he, "in the city and in the state, through the legislature, as a factor to be consulted in all proposed laws affecting merchandise credits. With all due modesty, yet with full confidence in what I declare, I say to you that we have it in our power to-day to dictate what bills introduced into state legislatures shall or shall not become laws, in so far as they affect us credit men."

Influence
of Credit
Men's As-
sociation
increasing.

The Committee on Investigation went by that name until the annual convention of 1898 when it was changed to the Committee on Investigation and Prosecution. Nearly all the local associations have similar committees and as a rule they work in cooperation with the national committee. Cases of insolvency are investigated and when evidence exists to show that there has been a fraudulent conversion of assets, the evidence is placed with a prosecuting attorney and the merchant is prosecuted. The

Change of
Investiga-
tion Com-
mittee.

purpose of the committee is not to make collections but to prosecute the guilty.

At the meeting of 1898 a series of resolutions was passed which provided for the employment of attorneys to investigate and prosecute frauds. Provision was also made for urging the local associations to report to the Investigation Committee of the National Association all cases of failure, whether fraudulent or not.

Prosecution of fraud. Provision was also made for urging the local associations to report to the Investigation Committee of the National Association all cases of failure, whether fraudulent or not. It was made the duty of this committee to investigate the debtor's commercial record, present affairs, capacity and character in order to make recommendations to the involved creditors as to a reasonable compromise if the debtor was honest, and as to the extension of such aid as would enable the debtor to continue in business.

In 1899 after the national bankruptcy law was passed, a plan was submitted by the national secretary to the local associations for discussion at their meetings. The plan provided for the submission of all offers for the compromise of indebtedness to the Investigation Committee of the State and National Associations, and creditors were pledged to refuse offers of compromise until the investigation by the constituted authorities should take place. The spirit if not the letter of this plan was later carried out. A fund was voted to be used in the investigation and prosecution of fraud, and individual creditors were pledged not to accept compromise offers of settlement.

The difficulties involved in carrying on the work of investigation and prosecution by the National Associa-

tion were seen to be almost insurmountable and the Board of Directors of the National Association at their meeting in 1903 decided to abandon operations under the investigation and prosecution fund as far as new cases were concerned.

Prosecution
Bureau.

The following year, however, the National Association, instructed the directors to reorganize the Investigation and Prosecution Bureau as an adjunct to the national work, and recommended "that a trust fund of \$50,000 be raised with which to equip and maintain the bureau."¹

The Secretary-Treasurer immediately sent out communications to the local associations to obtain opinions on the proposed plan with reference to the collection of the fund. The plan suggested did not meet with approval of the local associations, and the board of directors at its next meeting decided to abandon the project. They recommended that the work be taken up by the local associations in their respective districts, and that the costs of investigation and prosecution be borne by the association or associations interested. This seems to have been the best way of disposing of the matter, since the local associations can organize much more effectively to investigate and prosecute cases in their own district than a committee or bureau of the National Association can handle the cases arising in all parts of the country—often, indeed, in those parts with which they are but slightly familiar.

¹ Resolution of National Association, 1904. Bulletin, June 19, 1905.

The Committee on Credit Cooperation was organized in 1904. It was not thought advisable to establish a credit exchange bureau, but it was considered desirable that there be a greater interchange of ledger experience among members of the Association. The committee appointed limited itself to advocating a large degree of interchange of information, and this committee was retained for 1905. Many local associations and many trades have credit exchange bureaus.

The Committee on Fire Insurance that was recently installed, at first used its influence to induce debtors who had an insufficient amount of fire insurance to insure themselves adequately. Since then it has prevailed on many of the local associations to appoint standing committees on fire insurance. At the National Convention of Credit Men held in Minneapolis in June, 1911, the Fire Insurance Committee submitted the following resolutions, which show clearly the position of this committee with reference to fire insurance.

"Resolved, That the National Association of Credit Men in convention assembled, recognizing that the present conditions of fire insurance and fire waste are imposing an unwarranted and unnecessary burden upon our people, makes an earnest appeal to its members and particularly its affiliated branches to double and redouble their efforts to secure relief from these conditions.

"First, by using every means at hand, and especially the

literature of our association, to give the public in general a thorough understanding of the problems.

"Second, by making a conscientious study of local hazards especially as cited in the reports on cities and towns as issued by the engineers of the National Board of Fire Underwriters, and, acting upon them, demanding of the municipal authorities that such hazards be reduced or eliminated.

"Third, by endeavoring to secure in every state the enactment of a fire marshal measure modeled as closely as possible upon the bill as introduced, largely through the instance of this association, in the Legislature of the State of New York.

"Fourth, by keeping in touch with the state departments formed under the fire marshal laws with a view to securing from them the highest possible efficiency.

"Fifth, by cooperating with other organizations, such as state fire protection associations formed to reduce the losses of their respective states."

II. LOCAL ASSOCIATIONS OF CREDIT MEN

When the National Association of Credit Men was formed in 1896, there were thirteen local associations of credit men.¹ In July, 1912, there were ninety-one local credit men's associations affiliated with the National Association and thirty-seven states were represented.

¹ These were located in the following cities: New York, Detroit, Cincinnati, Sioux City (Iowa), Portland (Oregon), St. Joseph (Missouri), St. Louis, Kansas City, Memphis, New Orleans, Louisville, Nashville, St. Paul and Minneapolis.

The purposes of the early associations were (1) to reform the legislation of the states regarding bankruptcy, (2) to prevent creditors from being defrauded, (3) to make more uniform the conditions under which credit is given, (4) to increase and diffuse knowledge in regard to credit, and (5) to make unity of action possible where the interests of credit men were involved. The progressive work of the associations was done by the committees. The legislative committees were especially active. Laws in the various states were introduced at their suggestion, and through cooperation with the National Association of Credit Men, a campaign was begun which has tended to make the laws of the various states more uniform.

Most of the local associations hold several meetings each year, some as often as once a month. The topics for discussion at these meetings cover a wide range. They are usually those of immediate interest to credit men, such as The Bulk Sales Law, Corporation Reports, Credit System in Commercialism, The Adjustment Bureau, Credits, Credit Exchange, Law for the Credit Man, The Bankruptcy Act, Mercantile Agency Service, Collections, Idealism in Business, Systems and Methods of handling Accounts and Collections, Fraudulent Cases, The Bankruptcy Law and its Repeal, etc.

Soon after some of the local credit men's associations were formed, plans were adopted for exchanging credit information. With some of the associations the credit clearing house work became a prominent feature. Some have organized both a credit exchange bureau and an

adjustment bureau. In other cases the Adjustment Bureau work has been introduced without a Credit Exchange Bureau. When the Clearing House Bureau was organized as a part of the work of the association, the exchange of credit information became an adopted policy.

PART II
LEGISLATION

CHAPTER XV

BANKRUPTCY LEGISLATION

THE right to contract and the enforcement of contracts are almost as old as the race. In primitive societies public opinion and custom compelled the enforcement of contracts. They cover a variety of things, but usually are concerned with commercial agreements. The trade relations of people were the earliest relations between families and states. Barter was, of course, the earliest form of the trade relation. When the buyer did not have goods to exchange for the commodities of the seller, he gave wampum, beads, or some of the many other instruments used by primitive people, which could be exchanged by the seller for goods needed. These were the earliest and crudest forms of money. When the medium of exchange did not exist or was not in possession of the buyer, he agreed to deliver goods or services to the seller as a compensation for the commodities received. This was the earliest kind of contract. It had the sanction of the public opinion of the group and was enforced by that sanction.

Contracts
of primi-
tive
people.

When political organization became more definite, states prescribed by formal laws what the people should do and should not do, which was deemed imperative to the welfare of the states. In this

Early legislation with reference to debts. development of state activity laws governing trade relations were everywhere passed. These laws always favored the creditor. He had parted with something valuable and took chances on a loss until the state gave him some redress. To protect the creditor the early laws were of a drastic character. At that time the right of action against the debtor's property was of less significance to the creditor than it is now. He frequently had but little property, and the surrender of the person of the debtor either for his imprisonment or for the taking of his life was considered necessary to protect the interests of the creditor. All the early bankrupt laws provided either imprisonment for the debtor or the death penalty. Until the nineteenth century the death penalty for those who failed to pay their debts was very common.

Modern views with reference to the relations between debtors and creditors. In conformity with the changes in industrial organization in modern times, and especially in the nineteenth century, the relations between debtors and creditors, and also contract relations, have changed. The spirit of commercial interdependence has given rise to the idea that the grantor of credit is in a measure a partner of the debtor. In the big undertakings of the present day, business cannot be carried on without borrowed capital. To carry on enterprises and to develop resources, undertakers must borrow money. In lending, the creditor makes an investment and takes chances on the outcome.

He inquires into the character, earning ability, etc., of the borrower and makes his investment based upon his investigations. The borrower invests the capital procured in an enterprise more or less hazardous, with the hope of realizing returns which are roughly in proportion to the risks of the undertaking. In new countries investments involving great risks are made much more frequently than in older countries, and interest rates are consequently higher since they cover risks. Great business risks are necessary to the rapid development of a new country, and often the rapidity of the development is proportional to the degree of risk. Although many succeed, a great many fail, and those who succeed render important social services. Where this situation prevails, the honest investor who has been unfortunate cannot be looked upon as a criminal. The creditor who considers the nature of his investment and who accepts a high rate of interest because the risk is hazardous, has no special claim in equity against the debtor who deals honestly with him aside from the surrender for the creditor's benefit of the property of the debtor. In accordance with this conception of business ethics, which became pronounced in the early half of the last century, laws were passed in England and America dealing leniently with honest debtors. These laws first prohibited the death penalty and imprisonment. Then they held the bankrupt responsible in debt payment for only the amount of property which he possessed at the time of his failure. Any other legal position than this would not have been

in keeping with the commercial development above described.

Every modern state regulates by bankruptcy or insolvency laws the relations between creditors and their debtors who fail to pay their debts. Ordinarily an insolvent is one who cannot pay his debts or one whose liabilities exceed his assets.¹ Insolvency is necessary to bankruptcy proceedings. In some countries, France, Austria, and Germany, a stoppage of payments results necessarily in bankruptcy proceedings. In England, Denmark, Norway, and the United States, "Acts of bankruptcy" are necessary to bring about an adjustment of bankruptcy; while in other countries the courts must determine what conditions of the cessation of the payment of debts will result in bankruptcy proceedings.² In Belgium, Italy, and Spain the payment of debts may be suspended under certain circumstances without the debtors going into bankruptcy. In Italy the consent of a majority of the creditors is necessary for a suspension of payments. In both Belgium and Spain debtors are allowed to establish with creditors compositions which forestall bankruptcy.

In all the southern countries of Europe except Spain, bankrupt laws are applicable only to traders, whereas in the northern countries of Europe and in the United States all classes of debtors are subject to the bankruptcy

¹ See Lentholt: *Russische Rechtskunde*, Leipzig, 1879.

² Dunscombe: *Bankruptcy*.

laws. It was not until 1881 that Spain established a bankruptcy law for traders as well as non-traders. As early bankruptcy laws were drastic in character, the privilege of bankruptcy was a doubtful one. But since bankruptcy has come to mean a cancellation of debts if the bankrupt has not been dishonest and if he surrenders his property, the trader enjoys advantages over other classes in countries where bankruptcy is denied to nontraders, since there the latter class must pay all their debts in full.

Classes to
which
bank-
ruptcy
laws
apply.

In all countries distinctions are made with reference to causes of insolvency based upon the culpability of the debtor who goes into bankruptcy. In some countries notably France, Belgium, Italy, and Switzerland, a distinction is made between insolvency, simple bankruptcy, and fraudulent bankruptcy. A failure without any fraudulent circumstances attending it, is an insolvency. Degree of guilt is recognized as a distinction between simple bankruptcy and fraudulent bankruptcy, for each of which offences a prison sentence is prescribed. Such offences as excessive personal expenses, speculating in stocks, giving preferences to creditors, failing to keep proper books, etc., are recognized as causes of simple bankruptcy. In many other countries in which the above terms are not used, we find similar distinctions in which the treatment of the debtor depends upon whether or not he was guilty of misconduct.

In-
solven-
cy,
simple
bank-
ruptcy,
fraudu-
lent bank-
ruptcy.

There are three ways in which bankruptcy proceedings may be initiated: (1) by declaration of the debtor himself; (2) by the petition of one or more creditors; and (3) by action of the court which has jurisdiction. In some countries bankrupts are given the privilege of applying for a judgment of bankruptcy. In others, as soon as the debtor is unable to pay his debts, it is made his duty to make known the condition of his affairs. The petition of the debtor is an act of bankruptcy both in England and the United States. In many countries¹ any creditor regardless of the amount of his claim, may place a debtor in bankruptcy by petition.

In most countries in former times as soon as bankruptcy proceedings were instituted the bankrupt could be put

Treatment of debtor during bank-ruptcy pro-ceedings. in prison. Recently the rigor of these laws has been lessened and imprisonment is resorted to only in exceptional cases. In all instances the declaration of bankruptcy deprives the debtor of the possession and control of his property, until his relations with his creditors have been adjusted. Since the period of becoming insolvent is a gradual one, the time at which the debtor's control of his property must cease is in nearly all countries extended back beyond the time of the declaration of bankruptcy. The laws and practices of countries vary greatly on this point.

In the adjudication of bankruptcy a court of competent jurisdiction has charge of affairs. In the various

¹ France, Spain, Italy, Belgium, Germany, Austria and Hungary.

countries this court appoints trustees, administrators, etc., to take control of affairs, to investigate the conduct of the bankrupt, to take charge of the estate, and to insure to each creditor his valid claims. Everywhere an assembly of creditors is given privileges and rights which vary with the laws of the country. But whatever the system in vogue, the property of the debtor is administered and distributed among the creditors under the supervision of the court that has charge of the bankruptcy proceedings. In the closing up of the bankrupt's affairs, certain precautionary measures are everywhere employed. An inventory giving a full description of the bankrupt's property and an estimate of its value, is taken. All creditors must prove claims against the estate. To guard against the misappropriation of funds, the administrators are held responsible for misconduct and negligence; in many cases they are required to give bond, and in some cases the funds received must be kept in a public treasury.

In many countries the ordinary course of bankruptcy procedure may be avoided by arrangements between the debtor and creditor, known as compositions, by which they themselves agree to terms of settlement. By the composition the debtor retains or is restored to the management of his business and is often discharged from a portion of his liabilities when he carries out certain stipulations. An extension of time to meet his obligations is sometimes granted the debtor. As it is impossible to secure unanimity of action among creditors, in most

Bank-
ruptcy
pro-
ceedings.

countries a majority of them is given power to bind the minority in making compositions. However, a double majority is required, that is, numerically and in assets varying from a simple majority in number and three-fifths in value as in Spain, to a two-thirds majority in number and four-fifths in value as in Hungary. The approval of the proper judicial authority is required in all countries.

The method of discharge is different in England from that of the Continent. On the Continent the court must

The discharge of debtor. either approve or reject the composition agreed upon by creditors. It has no right to modify it, nor can it grant a debtor the privilege of a

composition on his own motion. In England on the other hand the court may discharge a debtor from his debts after he has paid a portion of them. In England Legislation of this sort more lenient to debtors began in the reign of Queen Anne and culminated in the Acts of 1883 and 1890.

Within the last fifty years what is known as Preventive Compositions have been adopted by several European

Preventive compositions. countries and the United States. They are arrangements entered into between creditors and debtors by which the latter avoids going through bankruptcy proceedings. They are intended primarily for the benefit of insolvent debtors, but are beneficial to creditors also. When the debtor makes a request for the privilege of entering into a composition with his creditors, he is usually required to report to the court the names of his creditors, their residences, the amounts owed each, a statement of his

assets, and a proposition for composition. While negotiations are pending, the debtor cannot transfer any portion of his property, or do anything which will affect the condition of his estate. During this period all suits and executions against the debtor are suspended. The composition must be agreed to by a majority of the creditors, the action of which is usually binding on all the rest.

The first English law providing for a preventive composition, passed in 1869, placed the control of the composition almost exclusively in the hands of the creditors and debtor, with only a nominal control by public authority. The clerk of the court was required to register the composition, but in doing this his power was restricted to his seeing that necessary formalities had been complied with. This Act was exceptional in legislation of this class, for the negotiations were free from judicial control and the agreements entered into did not require the confirmation of a court.

The laws of 1883 and 1890 reversed the policy of the law of 1869 by giving the court supervision over the negotiations between creditors and debtor, by making the confirmation of the court necessary to the validity of agreements between them, and by giving the court the power of veto; that is, of refusing to approve a composition when it seemed that the interests of all classes warranted such action. In all the Continental countries, the proper court exercises supervision over compositions, and the confirmation of a composition is necessary to the validity of an agreement.

In most countries certain civil, commercial, and polit-

ical rights are lost to debtors through bankruptcy proceedings. European countries may be classified in three groups with reference to the severity of bankrupt laws: (1) In France, Belgium, Spain, Italy, and the Netherlands the debtor must pay all his debts in full before he can be restored to full civil rights; (2) in Germany and Austria, as a rule, the debtor is restored to all his rights upon the conclusion of bankruptcy proceedings; (3) in England the debtor is restored to all his rights when he is discharged by the court and a certificate is given him to the effect that his insolvency was due to misfortune. He is also freed from all disabilities when the bankruptcy is annulled after it has been established that his debts have been paid in full.

In the first two of the above groups there are many exceptions. In Spain and Italy a debtor is restored to his rights when a composition has been granted and all its conditions have been fulfilled. In the Netherlands a debtor is treated similarly if he has acted throughout in good faith. In France and Belgium before the debtor can be restored to his rights he is required to pay all his debts, even those from which he has been excused by the terms of the composition. In Spain after those who have obtained a composition have complied with its conditions they may be given all their rights; whereas all other bankrupts must pay their debts in full to obtain the same privileges. As a rule, fraudulent conduct prevents the restoration of rights to a bankrupt, and in some countries the fraudulent are punished with penal servitude.

CHAPTER XVI

THE BANKRUPT LAW OF 1800

ALTHOUGH the Constitution of the United States has been in force 123 years, in but thirty-one years have we had national bankrupt laws. In this respect our experience has been different from that of most foreign countries. England has had a bankruptcy law since the reign of Henry VIII, her last Act having been passed in 1890. Practically all other European countries have bankruptcy systems. It must not be inferred, however, from our experience with national bankrupt laws, that the United States is opposed to bankruptcy legislation. Many of the states have insolvency or some form of bankruptcy laws, and the opponents of national bankruptcy legislation in Congress have usually contended that this class of legislation should be left with the various states.

Authority for a national bankrupt law was given by the following clause of the Eighth Section of Article I of the Constitution: Congress "shall have power to establish a uniform rule of naturalization and uniform laws on the subject of bankruptcy throughout the United States." The changed attitude in favor of leniency to debtors is seen in the discussion in the Constitutional Convention; when this clause came up, "Mr. Sherman observed that bankruptcies were in

National
bankrupt
laws.

Right to
legislate
on bank-
ruptcy
given the
national
govern-
ment by
the con-
stitution.

some cases punishable with death by the laws of England; and he did not choose to grant a power by which that might be done here.”¹ In reply Mr. Gouverneur Morris said “that this was an extensive and delicate subject. He would agree to it because he saw no danger of abuse of the power by the legislature of the United States.”² Connecticut was the only state that voted in the negative on this clause.

That the interests of the creditor class were uppermost at the time, however, may be inferred from the following clause of the forty-second number of the Federalist written by Madison; viz, “The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property lie, or be removed into different states, that the expediency of it seems not likely to be drawn in question.” No mention is made of the rights of debtors.

The issue to define the scope of Congress in legislation on bankruptcy was first drawn between the strict and loose constructionists of the Constitution, the former claiming that the powers of Congress were restricted to those specially granted in the Constitution. When the Constitution was adopted, the bankruptcy legislation of other countries was limited to traders. The strict constructionists

¹ Journal of the Constitutional Convention, pp. 650–665. Madison.

² Journal of the Constitutional Convention, pp. 650–665. Madison.

consequently claimed that the clause of the Constitution giving Congress the right to pass bankruptcy laws limited the power of Congress in legislation to traders. The Supreme Court has since settled this dispute in conformity with loose constructionist theory in holding that the Constitution granted to the national government the right to legislate in bankruptcy not only for traders but for all classes of business men.

The depredations made on our commerce by Great Britain and France prior to 1800 disorganized our trade, and both debtor and creditor classes believed that it would be to their mutual interests to have a bankruptcy act passed which corresponded to the English law. It was in compliance with their demands that the first National Bankruptcy Act was passed April 4, 1800. The Act which was limited to five years, was an involuntary law; that is, action to make a man a bankrupt had to be brought by creditors. Like the English law and other bankrupt laws of the time, it was limited to traders—"merchants, traders, bankers, brokers, factors, and insurers." Other business classes, farmers, mechanics, laborers, and professional men of all classes were excluded from its provisions.

Two principles have since been incorporated into the bankruptcy or insolvency laws of the most progressive countries: (1) The relief of the honest debtor from imprisonment; and (2) The cancellation of the debts of the bankrupt if dishonesty has not been proved, and if his property has been

Law of
1800
limited to
traders.

Principles
in bank-
ruptcy
legislation.

surrendered for the benefit of his creditors. The first principle has usually preceded the second. Practically all European nations of to-day have accepted the first principle, but not all of them have accepted the second principle. In England, upon the other hand, the discharge or cancellation of the debts of honest bankrupts has been allowed since the reign of Queen Anne, while freedom from imprisonment was made possible at the beginning of the nineteenth century.

A distinction has been made as to kinds of business with reference to the culpability of the man failing. They were classified from the point of view of hazard and public utility, and those engaged in precarious occupations who failed were treated more leniently by the law than those failing in other business pursuits. Under the influence of the mercantile system, international trade was considered the occupation of greatest utility to a nation. It was likewise considered the most hazardous enterprise. Prior to the nineteenth century all bankrupt laws in England related to traders, and the bankrupt laws of most of the countries of southern Europe to-day are limited to traders. The mercantile teachings with reference to the comparative utility of enterprises had nowhere been swept away by 1800. It should be said, too, that during the eighteenth century trade was carried on under hazardous conditions. Credit was used more to carry on trade than in enterprises of any other sort. Large amounts of capital were not needed in manufacture until the industrial revolution, and the development of agriculture in the eighteenth

century was not dependent upon credit. The distinction which we find between occupations, by the laws of the period, had a real economic basis in the eighteenth century. Views to this effect were expressed by Mr. James A. Bayard while speaking on the repeal of the law of 1800, on February 18, 1803. "The most diligent and honorable merchants may be ruined without committing any fault. Not so as to the other classes of citizens; either the cultivators of the soil, the mechanics, or those who follow a liberal profession. They live on the profits of their labor, not on profits derived from credit."

Blackstone¹ in his commentaries on the laws of England states clearly the English theory with reference to bankruptcy in his time. Referring to the laws of Rome he says that "The laws of England, more wisely, have steered in the middle between both extremes; providing at once against the inhumanity of the creditor, who is not suffered to confine an honest bankrupt after his effects are delivered up; and at the same time taking care that all his just debts shall be paid so far as the effects will extend. But still they are cautious of encouraging prodigality and extravagance by this indulgence to debtors, and therefore they allow the benefits of the laws of bankruptcy to none but actual traders; since that set of men are, generally speaking, the only persons liable to accidental losses, and to an inability of paying their debts, without any fault of their own.

Black-
stone's
views on
bank-
ruptcy.

¹ Blackstone's Commentaries on Laws of England, Book 2, Ch. 3, p. 935, Lewis's edition.

If persons in other situations of life run in debt without the power of payments, they must take the consequences of their own indiscretion, even though they meet with sudden accidents that may reduce their fortunes; for the law holds it to be an unjustifiable practice for any person but a trader to encumber himself with debts of any considerable value. If a gentleman or one in a liberal profession at the time of contracting his debts, has a sufficient fund to pay them, the delay of payment is a species of dishonesty, and a temporary injustice to his creditor; and if at such time he has no sufficient fund, the dishonesty and injustice is the greater. He cannot therefore murmur, if he suffers the punishment which he has voluntarily drawn on himself. But in mercantile transactions the case is otherwise. Trade cannot be carried on without mutual credit on both sides: the contracting of debts is therefore here not only justifiable but necessary. And if by accidental calamities, as, by the loss of a ship in a tempest, the failure of brother traders, or by the non-payment of persons out of trade, a merchant or trader becomes incapable of discharging his own debts, it is his misfortune and not his fault. To the misfortunes therefore of debtors, the law has given a compassionate remedy, but denied it to their faults; since, at the time that it provides for the security of commerce, by enacting that every considerable trader may be declared a bankrupt, for the benefit of his creditors as well as himself, it has also (to discourage extravagance) declared that no one shall be capable of being made a bankrupt, but only a trader; nor capable of receiving

the full benefit of the statutes, but only an industrious trader." Traders, however, were not benefited by bankruptcy laws until provision was made for a discharge which involved the cancellation of their debts after they surrendered their property for the benefit of their creditors. There are those who claim that bankruptcy laws were of no benefit to traders until they included voluntary provisions making it possible for debtors to invoke the laws for their own benefit. However, American experience with the first National Bankrupt Act, as will hereafter be seen, tends to disprove this contention.

The law of 1800 was restricted to merchants and traders. As in the case of subsequent American bankrupt laws and most foreign laws of a similar character, the commission by a debtor of acts of bankruptcy was necessary to his adjudgment as a bankrupt. From a general point of view the debtor could be declared a bankrupt when he was guilty of fraud, or when he exhibited a disinclination to pay his debts. Specifically a debtor could be adjudged a bankrupt for the commission of any one of the following offenses: (1) When in order to defraud his creditors he left the state where he usually resided; (2) when he concealed himself for the purpose of fraud; (3) when he conveyed his property for fraudulent purposes; (4) when he preferred creditors; (5) when he willingly and fraudulently permitted himself to be arrested; (6) when he remained in prison over two months or when he escaped from it for purposes of fraud; (7)

Who could
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when he did not within a reasonable time make provision for the payment of his debts after his property had been attached.

The law made a distinction between the fraudulent bankrupt and the debtor guilty of bankruptcy without

When a debtor could be adjudged a fraudulent bankrupt. fraudulent intent. A debtor could be adjudged a fraudulent bankrupt, for which offense he could be imprisoned for a term of from one to ten years, and could be ever afterward denied the benefits of the act for any one of the following offenses: (1) Refusing, within forty-two days after being adjudged a bankrupt and receiving notice of the execution of bankruptcy, to surrender himself to the commissioners of the bankrupt to be examined by them with reference to the state of his affairs; (2) refusing to surrender all of his property to the commissioners except the minimum allowed by the Act; (3) testifying falsely with reference to his property, its transfer, etc., and all books, papers, etc., relating to it; and (4) upon conviction of a wilful default. If, while being examined by the commissioners of bankruptcy, the bankrupt committed "wilful or corrupt perjury," he could be indicted for it, and was made subject to imprisonment for a term of two to ten years.

Upon the other hand, the bankrupt who surrendered his property to the commissioners to be divided among his creditors and who gave a thorough and exact report of his affairs, should be discharged. A discharge meant not only freedom from imprisonment, but a cancellation of all the debts which the debtor then owed.

The judge of the district court of the United States had charge of all cases of bankruptcy arising in the district. The petition to make a debtor a bankrupt had to be presented to him by a creditor, who was required to give bond to indemnify the alleged bankrupt for damages in case bankruptcy was not established. When the petition was filed, it became the duty of the judge to appoint commissioners residing in the district, not to exceed three, to determine on the question of bankruptcy and, in case the debtor was adjudged a bankrupt, to take charge of his property. When notice was served upon the debtor, summoning him to appear and answer the charge of bankruptcy, it was his privilege to demand that a jury should inquire into the facts of the case, at which time the judge issuing the commission should preside. As soon as the debtor was declared to be a bankrupt, the commissioners should appoint a time and place for the meeting of creditors, at which time they were required to prove their debts and elect an assignee or assignees to take charge of the debtor's property. As soon as the assignee was elected it became the duty of the commission to transfer to the assignees all the property of the debtor, except the minimum allowed by law, which was of a personal character. The commissioners were also authorized to recover all property illegally conveyed or concealed and to place it in the hands of the assignees.

After four months and within twelve months of the issuing of the Commission of Bankruptcy, the assign-

ees were required¹ to appoint a place of meeting of the assignees, commissioners, and creditors, after giving thirty days notice. At this meeting accounts were to be balanced, and the property of the debtor was to be divided among the creditors in proportion to the claims of each. In case the bankrupt's entire estate was not divided at the first meeting, a second meeting was to be called for the distribution of the remnant of it within eighteen months after the Commission was issued. The allowances to the assignees for their services were to be made by the commissioners, but "the district judges in each district shall fix a rate of allowance to be made to the commissioners of bankruptcy."²

The only property of the bankrupt which was not required to be surrendered were the clothing, beds, and

The amount of property allowed a bankrupt. bedding of himself and family. If the assets of the bankrupt paid 50 per cent. of his debts, then he was allowed 5 per cent. of the net value of his estate, provided that this amount did not exceed \$500. If his estate paid 75 per cent. of his liabilities, he was allowed 10 per cent. of the proceeds of his estate, if this amount did not exceed \$800. But if the assets of the bankrupt did not pay 50 per cent. of his debts, then he was to receive what the commissioners would allow, the amount not to exceed \$300 or 3 per cent. of the net value of the estate. If the bankrupt was not proved to be dishonest, his debts were to be cancelled after his estate was surrendered

¹ A single assignee might have control of the estate.

² Section 47.

for the benefit of his creditors. The bankrupt, however, was to lose all title to the allowance of a portion of his property, and a right to a discharge which freed him from the payment of the balance of his debts, if it could be proved that he had permitted a creditor to present a fictitious or unfair claim. He was to suffer the same penalty if he had lost at any one time fifty dollars, or \$300 in all, in gaming or wagering. A bankrupt who failed a second time could be relieved from punishment, but he could not be discharged from the payment of all his debts, unless his assets paid 75 per cent. of his obligations.

In one sense the law was intended as an experiment as its operation was limited to five years. However, it was repealed December 19, 1803, after it had been in force somewhat over three years. The vote in the Lower House, 94 to 13, showed that the sentiment there against the law was very strong.¹

The chief arguments for the retention of the law, were as follows:

1. The correct policy would permit the law to expire by its own limitation. As it was intended as an experiment, five years should be allowed to test its value. General commercial distress demanded the kind of law which was passed in 1800. Radical amendments, which experience has proved necessary, should be incorporated in the law and it may then be of permanent value.

2. Well-informed writers and merchants believe that

¹ In the Senate the vote in favor of repeal was 17 to 12.

Reasons
for re-
taining the
law.

more privileges should be given to men engaged in trade than in other callings. The exemption of property from the payment of just debts is not a violation of justice in certain circumstances in the case of commercial concerns. Although inability to pay debts ordinarily results from idleness or imprudence, in the case of commerce risks are so great that nothing can guard against failures.

3. Relief to unfortunate worthy traders cannot be granted by states, since their laws are various and contradictory. Of all occupations, trade is widest in range, and laws governing trade should be equally wide and extensive.

4. Credit and trade are the chief sources of wealth accumulation. It would be unwise to have regulations which would hinder their natural development.

5. The bankrupt law did not always operate in favor of the debtor, as the opponents of the law claimed. Under the insolvent laws of the states the debtor can determine when he will go into insolvency. Under the national bankrupt law the debtor cannot decide when he will go into bankruptcy, while creditors can take action to stop the reckless and hazardous career of a debtor by initiating proceedings to make him a bankrupt.

6. The bankrupt law lessens the temptation to fraud since there is less opportunity for concealment of fraudulent conduct. Moreover, if it is considered desirable, state legislatures may, without violating the national law, pass laws providing drastic treatment for fraud.

7. The primary purpose in providing by constitutional enactment for the giving of power to the national govern-

ment to pass bankruptcy laws, was to establish the national credit upon a firmer basis. The repeal of the law will mean a return to the partial and inadequate system of the states with reference to credit and debts.

8. If the law was retroactive as to the relations between debtors and creditors, as many claim, and consequently injurious, its repeal before the expiration of five years will change again the relations of debtors and creditors, and on this account be harmful.

The arguments in favor of the repeal of the law were the following:

1. As Congress was responsible for the evils of the law, which were numerous, it would be wrong to permit the law to expire by limitation. Those who ordinarily try to avoid bankruptcy are now placing themselves in a position to get its benefits.

2. The bankrupt law had a bad effect on the morals of the mercantile world; it created credits and excited a spirit of extravagance in expenditure. The opponents of the law pointed out that as a result of the law small traders were often found living in ease and great luxury.

3. The provisions of the law operated in favor of the debtor. Although the commission of bankruptcy was always taken out at the instance of a creditor, it was pointed out that the creditor who took the initiative in most instances was a friend of the debtor who acted under his guidance. The commission of fraud led to demoralizing consequences.

4. The bankrupt law could not be carried into effect

Arguments
for the
repeal of
the law.

suecessfully without a resort to a class of laws to prevent fraud, passed by England and other countries, which were so drastic in character as to be abhorrent to our code of morals.

5. The expenses of going through bankruptcy were out of proportion to the assets to be divided, owing to the high fees of the commissioners and assignees.

6. Trade does not need any special protection. The commercial world is always fair to honest debtors.

7. The law was harmful in that it enlarged the powers of the federal courts and of the general government. It was claimed that many powers were given the general government by the Constitution without a view to their exercise.

8. Of most weight in securing the repeal of the law was the contention that it was partial in its application, since it discriminated in favor of the merchant and trader to the detriment of the farmer and mechanic. If the merchant failed, he could be relieved from the payment of all his debts, whereas if the farmer or mechanic failed, he was under obligation to cancel every item of his indebtedness. If the farmer loaned to the merchant and the latter failed, the farmer was then unable to collect a part of the debts due him. If on account of the failure of the merchant the farmer failed, the latter was afforded no protection whatever by the law. It was stated that our law was a modified form of the English law at that time, and it was argued that as our economic conditions were very different from those of Great Britain a good law there might prove to be a very poor one here. There

the dominant industry was commerce, and hence the legislative favoritism to the mercantile classes. Here the chief industry was agriculture, and it was unjust and detrimental to the general good to discriminate against the farming class. It was claimed that a preferred system that treated all insolvents alike had been adopted by some of the states.

9. Of importance, secondary only to the last argument, was the contention that while justice dictated the liberation of the body of the bankrupt, that same justice demanded that the obligation to pay just debts was eternal. When the law was passed, it was claimed to be retroactive and to be the cause of great harm to creditors by enabling debtors to be discharged from the payment of obligations incurred before the passage of the Act.

The clause in the law which relieved from seizure the property acquired by the bankrupt after he was discharged, arose from the newer credit relations and was in the interests of the public welfare. The discharge of the debtor formerly meant simply relief from punishment. It was assumed that he was under both moral and legal obligations to pay his debts. Relief from the legal obligation to pay was looked upon by many as the bestowal of an unwarranted and dangerous favor. It was held that if the government relieved debtors from paying their debts in full, it permitted the violation of contracts, and that its effect would be demoralizing. It was claimed that in making it easy for the debtor to go through bankruptcy proceedings, by which a portion of his debts could be cancelled, the government would

work harm upon industry since carelessness in borrowing and in investing would result. That an effective protest should be made against the release of the honest bankrupt from the payment of his future earnings shows how little headway our modern ideas of credit and business had made at the time.

CHAPTER XVII

BANKRUPTCY ACT OF 1841

THE second National Bankruptcy Act of the United States was passed Aug. 18, 1841, went into effect Feb. 1, 1842, and was repealed on the 3rd of March, 1843, having been in operation slightly over thirteen months. Shortly after the repeal of the law of 1800, agitation was begun for a new bankruptcy act. Interest in such a law was always strongest after periods of depression, since debtors and their friends were particularly vigilant in importuning Congress to pass a bankruptcy act which would remove the burdens from the former class and permit them to begin business again. Bankruptcy Bills were frequently before Congress, but the friends of such measures were particularly aggressive in 1818, 1820, 1822, and 1826. Most of these measures were copied after the English law then in force, and all the friends of the measures appealed to English experience to prove the need of such a law here. In nearly all cases the proposed measures limited the benefits of the law to traders, and in most cases they were involuntary measures. All of them proposed three things: 1. The surrender of the property of the debtor for the benefit of his creditors; 2. the relief of the debtor from punishment if dishonesty

Agitation
for a
second
National
Bankrupt
Act.
What pro-
posed Acts
aimed to
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plish.

had not been proved; 3. the discharge of the debtor from the obligation to pay his debts. In all these discussions, the "State Rights" advocates were strongly opposed to a national bankrupt act, whereas in general the loose constructionists favored such a law.

It was urged that the trader or merchant ought to be governed by a different set of rules than that governing farmers, mechanics, wage-earners, professional men, etc.

Why the traders were made a special class. The business of the traders and merchants is more speculative and hazardous than that of the latter classes and in the nature of things must be so. With the former it was claimed that failure is frequently due to misfortune and miscalculation; and, where this is true, the welfare of both the state and the creditor class as well as that of the debtors demands the discharge of the debtor, a thing which relieves his future earnings from attachment to pay his debts.

Foreign experience. In the discussion in the House in 1822, it was pointed out that the first Bankruptcy Act of England was passed in the reign of Henry VIII; that this Act then remained in force through all political and industrial vicissitudes; and that the only changes which were made in it consisted in lessening the rigor of the law with reference to debtors. Other nations had bankruptcy laws with varying degrees of severity. The chief difference between them consisted in the required proportion and number of creditors whose opinion, in regard to the effects of the debtor, should control and bind the rest.

In 1819 a report was made by the chancellor and judges of the Supreme Court of New York to the Legislature of that state on its insolvency law. This body reviewed the insolvency legislation of New York beginning with the law of 1784. It commented favorably on the Act of 1813, which required every insolvent debtor to make application for relief in the county where he resided or was imprisoned. It was pointed out that the insolvent law in New York was intended to relieve the debtor from the payment of his debts and to free him from imprisonment after he had surrendered his property for the benefit of his creditors. At this time, in New York, those not free holders charged with small debts could not be imprisoned for a longer period than 60 days; and any one owing debts less than \$500 might be discharged, whereas if one owed debts larger in amount, an application for a discharge must be made. This committee recommended the repeal of the State Insolvency Law, claiming that a National Bankrupt Act would be superior to the insolvency laws of the states.

It was claimed that commercial interests were in need of a law to keep the debtor "in failing circumstances, from disposing of his property partially among his creditors, or from fraudulently wasting it, or converting it to his own use."¹ The preservation of the debtor's estate and its protection in the interests of the creditors were to be the chief factors in a national bankrupt law if this committee

New
York's
experience
with insol-
vent laws.

Purpose
of a bank-
rupt law.

¹ Niles Register, Vol. 16, p. 85, Sup.

had the making of the law. It was held moreover that a permanent law to relieve debtors would be demoralizing.

The chief argument for a bankrupt Act at this time was that the act would discharge debtors who had

Reasons
assigned
for pass-
ing a
bankrupt
Act in
1822.

become involved in debt owing to extravagant speculation and the unsettled industrial conditions. It was claimed that the Embargo, Non-intercourse Acts, and the War of 1812-14 had ruined thousands. After the war the opening up of new lands with the attending

land speculation, and the unsettled banking and monetary situation of the country, had caused many more to fail. Many of these were not fraudulently culpable, it was argued, but were simply unfortunate; and for this reason their debts should be cancelled and they should be permitted to start in business again. Commercial prosperity and even the interest of the creditors themselves demanded this.

The arguments of the opposition, however, at this time prevailed. They argued that the cancellation of

Arguments
of those
opposed to
the law.

debts would violate contracts and the effect would be demoralizing. They insisted that such a law would be an invitation to conduct

hazardous enterprises and then repudiate just debts in case of business failure. They claimed that the industrial conditions in England were so different from those in America that a good law there might be a very poor one here, and that it was unwise to follow the English precedent. Some claimed that the bankruptcy legislation in England was a failure. Quotations

were made from the report of the English commission of bankruptcy of 1818 to show this. The English law was limited to traders, but by a loose construction of the law it was extended to many other classes. It was pointed out that it would be impossible to tell who were traders and who were not. If the proposed law included others than the trading class, it would demoralize those who had absolutely no need for a bankruptcy law. The law before Congress in 1822 contained a clause extending the provisions of bankruptcy to "other persons actually using the trade of merchandise, by buying and selling, in gross or retail."¹ It was claimed that this clause would include the miller who converts wheat into flour, and the distiller who purchases grain for manufacturing purposes, and many others who would not logically belong to the merchant or trading class. In 1827 another Act was introduced to include farmers within the provisions of the law. The influence of the law on the farmer in withdrawing him from his regular occupation and tempting him into the questionable occupation of speculation in lands and other fields for which he had no qualifications, was dwelt on at considerable length. Between the repeal of the law of 1800 and the passage of its successor in 1841, important decisions were made by the courts affecting bankruptcy, decisions which determined in large measure the subsequent course of legislation on bankruptcy.

Those who were opposed to the extension of power by the United States Government saw in the enactment

¹ Abridged Debates, House, Vol. 7, p. 280.

of a national bankrupt law another encroachment of the federal power on the prerogatives of the states.

Arguments of those opposed to extension of power by the National Government. Since the insolvent laws of the states were in force so long as there was no national bankrupt law, and since the latter abolished them where the provisions of these laws were in conflict with the national law, the States Rights advocates viewed national legislation on bankruptcy with much concern. It was argued that without a national bankrupt

law the federal courts are chiefly concerned with the settlement of controversies between citizens of the different states. One debater claimed that the national law would effect a judicial consolidation of the Union, and would introduce radical changes in the relations between the state and federal courts. This contention, however, proved to be unfounded.

Inconvenience of attending federal courts. It was pointed out that a national law would impose heavy burdens on both debtors and creditors in attending the federal courts. At this time, North

Carolina constituted but one federal district; consequently all the citizens of the state would be required to attend the same bankruptcy court. Pennsylvania was divided into two districts, the sessions of each court being held at Philadelphia and Pittsburg, cities 300 miles apart.

Under modern conditions with many railways and fast trains, a burden almost unbearable would be imposed on people to go the distance required of residents of those districts at that time. But in the early twenties there

were no railways anywhere, and the highways over which the people would have to travel were in such a condition as to make attendance at these courts for the great majority of them, wholly impracticable. These facts were pointed out in these discussions, and they furnished the chief reasons for the defeat of the proposed laws.

The friends of these measures claimed that the clause requiring the consent of two-thirds of the creditors for the distribution of the estate of the debtor and for his subsequent discharge, adequately safeguarded the interests of the creditors. The opponents of these laws claimed that this clause offered no safeguard whatever; that the remoteness of the federal courts from the places of business of most of the creditors would prevent them from attending its sessions, and that the discharge of the debtor and the cancellation of his debts, would be made relatively easy. It was thus claimed that while these measures pretended to give adequate protection to the creditors, this protection was only apparent and not real. However, the arguments of the advocates of a national bankrupt law proved unavailing until after the crisis of 1837.

The right of a state to legislate on bankruptcy when a national law is in force, and the distinction between insolvency and bankruptcy laws and the right of a state to grant a discharge to a debtor when debts were owed a creditor in another state, were frequently mooted questions. The first two of these were answered by the Supreme Court of the United States in 1819, through

Chief Justice John Marshall in the famous case of *Sturgis vs. Crowninshield*.¹

On the first proposition the court held that "The rights of the states to pass bankrupt laws are not extinguished

by the enactment of a uniform bankrupt law throughout the Union by Congress, for they are suspended only so far as the two laws conflict. States are not forbidden to pass such laws. It is simply a question of the exercise of such power by Congress." State laws have always been effective during the absence of a national law. When a national law is passed, they cease to be operative but go into effect again when the national law is repealed. State laws on bankruptcy not in violation of the national law are also held to be valid by this decision.

With reference to the second proposition it was generally assumed that an insolvent law dealt with the person of the bankrupt, and the bankrupt laws dealt with his property. It was also held that insolvent laws are enforced by debtors, and bankrupt laws by the creditors. The decision of the Chief Justice on these points is as follows:² "But if an act of Congress should discharge the person of the bankrupt, and leave his future acquisitions liable to his creditors, we should feel much hesitation in saying that this was an insolvent, and not a bankrupt act; and therefore unconstitutional. Another distinction has been stated, and has been uniformly observed. Insolvent laws operate at the instance

¹ *Sturgis vs. Crowninshield*, 4, Wheaton, 122.

² *Sturgis vs. Crowninshield*, 4, Wheaton, 122.

of an imprisoned debtor; bankrupt laws operate at the instance of a creditor. But should an act of Congress authorize a commission of bankruptcy to issue on the application of a debtor, a court would scarcely be warranted in saying that the law was unconstitutional, and the commission a nullity." This decision of the Chief Justice shows clearly that there is no necessary distinction between an insolvent and a bankrupt law, based either upon provision of the law or the conditions of its enforcement. This decision established also the constitutionality of a voluntary bankrupt law.

The third proposition in dispute, the right of a state insolvency law to discharge a debtor from obligations owed citizens of another state, was settled by the case *Ogden vs. Saunders* brought before the Supreme Court in 1827.¹ The decision established clearly two points: First, the right of a state to discharge by an insolvency law, a debtor from obligations owed citizens if contracted subsequently to the passage of the law; and second, the unconstitutionality of an insolvency law which discharges a debtor from obligations owed in another state, or contracted prior to the enactment of the law.

In 1837 and for several succeeding years, the country was visited by an industrial depression far more serious than any that preceded it. This was due to a variety of causes, prominent among which were the over-speculation in lands and other securities, an inferior monetary system, the adoption of

Crisis of
1837.

¹ *Ogden vs. Saunders*, 12, Wheaton, 213.

the policy by the government, with but little warning, that payment for government lands had to be made in specie, and the failure of crops in the United States in 1835, 1837, and 1838. Thousands of people in all walks of life failed, and recuperation from the panic was exceedingly slow.

All the arguments for a national bankrupt law which would cancel the obligations of debtors heretofore made after periods of temporary distress, were now repeated with great vigor. Finally after a long and heated discussion in which charges were made bordering on corruption, the bill passed both Houses of Congress and was signed by the President, August 19, 1841. The measure at first contained a provision requiring the Act to go into operation shortly after its passage. This feature was amended so as to postpone the time for it to go into effect until February 1, of the following year, with the result that an unsuccessful attempt was made to repeal the law before it went into operation. The bill was passed at an extra session, and Congress had convened again before the Act became a law.

This Act provided for voluntary as well as involuntary bankruptcy. Any one could become a voluntary bankrupt who owed debts not "created as a consequence of a defalcation as a public officer, or while acting in a judiciary capacity as executor, administrator, guardian, or trustee," and who conformed to certain definite conditions laid down by the law. He was required to make a list

The Act of
1841 was
passed.

Provisions
of Act.

Voluntary
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of his creditors, give their residence, state the amounts owed each, furnish an inventory of all of his property and state its location. After he had furnished these statements under oath, together with a declaration of his inability to pay his debts, the court was empowered to declare him a bankrupt.

The voluntary feature of the law was new in our legislation and met with great opposition. It was modeled after the English law of 1827, which provided for voluntary bankruptcy.¹ It was pointed out in the discussion in Congress that voluntary bankruptcy prevailed in England long before the passage of her so-called voluntary Act; and that at this time England legalized what had long been the custom there under involuntary bankruptcy. A failing debtor would arrange with a friendly creditor to commit an act of bankruptcy and have the creditor bring suit in bankruptcy. By this method it was within the power of debtors to determine when and how they could become bankrupts without a voluntary law. The friends of voluntary bankruptcy claimed that what had been the custom there could be practised here, and that no new or extraordinary privileges were given debtors by the Voluntary Bankrupt Act.

The law of 1841 limited involuntary bankruptcy to the merchant class—including “merchants, bankers, factors, brokers, underwriters, and marine Involun-
insurers, who owed debts to the amount of tary bank-
\$2,000 and were guilty of fraud.” The peti-
tion of one or more creditors to whom not less than
ruptcy.

¹ Abridged Debates, Vol. 14, p. 713.

\$500 was owed, was adequate to make a debtor a bankrupt. The commission of any one of the following offenses would make a debtor an involuntary bankrupt: (1) To depart from the state with intent to defraud creditors; (2) to conceal himself to avoid arrest or to have himself fraudulently arrested or to have his goods taken fraudulently in execution; (3) to conceal or to remove his goods to keep them from being detached or taken in execution; (4) to make a fraudulent conveyance. When a person was declared to be a bankrupt under these conditions, upon petition to the court he was entitled to a trial within ten days to determine the facts of bankruptcy. If the bankrupt lived a great distance from the place where the court was held, the court might at its discretion, have the bankruptcy proceedings held in the county where the bankrupt resided. This feature was incorporated into the Act partly to meet the objections of those who insisted that a National Act imposed heavy and unnecessary burdens on those who were compelled to travel long distances to attend the federal courts.

Transfers or conveyances of property for the purpose of preferring creditors were violations of this Act. All **Prefer-
ences.** payments or transfers made to those not bona fide creditors or purchasers were considered **Penalties.** fraudulent acts. In these cases it was made the duty of the assignee to recover property fraudulently conveyed as assets of the bankrupt. The bankrupt guilty of the above frauds was to be refused a discharge in bankruptcy. All dealings and transactions of a bona fide character made by the debtor more than

two months before the petition to make him a bankrupt was filed, were not invalidated by this Act if the other party to these dealings had no knowledge of a prior Act of bankruptcy or of the intention of the debtor to take advantage of the bankrupt Act. If a voluntary bankrupt preferred a creditor subsequent to the first of January preceding the passage of the Act he could not be discharged unless a majority of his creditors who had not been preferred, gave their consent to his discharge.

After the petition of bankruptcy was filed it was the duty of the court to appoint an assignee who should take control of the property and property rights of the bankrupt. The assignee was required to make sales, transfers, etc., as the court ordered. All moneys received were to be transferred to the court within sixty days after their collection. A division of the assets among creditors was to be made as often as once every six months. The assignee was given power to redeem mortgages or other pledges and to collect all moneys owed the bankrupt. For the purpose of closing estates as early as possible the court could require the assignee to reduce the property of the bankrupt to money and to divide it as early as was possible in the interests of the creditors.

It was provided that there should be exempted from seizure "the necessary household and kitchen furniture," and such other articles and necessities as the assignee having reference to the circumstances of the bankrupt should designate,

Appoint-
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assignees.
Their
duties.

Exemp-
tions.

but altogether not to exceed the sum of \$300. The wearing apparel of such bankrupt, and that of his wife and children were also to be exempted.

The bankrupt who surrendered his property and carried out the orders and directions of the court and **Discharge.** was not guilty of fraud, was entitled to a full discharge by the court unless a majority in number and in value of his creditors who had proved their debts had filed written objections to it. The discharge and certificate of discharge could not be granted until the court published in a newspaper for seventy days a notice to all creditors to appear at a particular time and place and show reason why a discharge should not be given. The court might, if it chose, notify creditors personally if they lived a long distance from where the sessions of the court were held.

The opponents of the law seriously objected to this feature. They claimed that in every country where a bankrupt law was in force, the consent of from one-half to four-fifths of the creditors in number and amounts owed, was necessary to a discharge. In the above named provision the debtor could be discharged unless over one-half of his creditors objected to it; and the method of informing creditors of the application for a discharge was not such as would insure the enlightenment of a very large percentage of them on the action taken by the debtor.

Debtors guilty of fraud as defined in the Act could not be discharged. Involuntary bankrupts who failed to keep proper books could not be discharged. When a

discharge was refused by the court on account of objections of creditors or because of fraud, the bankrupt might, if he petitioned within ten days, appeal the case to the next circuit court and demand a trial by a jury. When once discharged a debtor could not be discharged a second time unless his assets paid 75 per cent. of his debts.

The District Court in every district, had jurisdiction over bankrupt cases. Petitions in bankruptcy were to be made to the District Court where the bankrupt resided. After the petition, notices of it were to be published by the court in one or more newspapers of the district at least twenty days before the hearing. At this meeting creditors had to establish their claims. The Circuit Court within the district had concurrent jurisdiction with the District Courts in all suits brought by the assignee with reference to the bankrupt estate or by any one else against the assignee. All suits to be valid had to be brought within two years after the decree of bankruptcy.

The preference feature was introduced in this Act. In the distribution of the assets of the debtor, the following debts were preferred in the order named:

(1) Debts due to the United States; (2) debts due the sureties of a debtor; (3) wages of laborers not to exceed \$25 for services performed within six months of the bankruptcy of the employer. It was claimed in the House that one of the purposes of the law was to treat all creditors alike, and

Courts
having
jurisdic-
tion.

Who were
preferred
debtors.

that in preferring certain creditors its fundamental purpose was defeated. It was insisted also that it was unfair to others to make the United States Government a preferred creditor.

Since the Act was passed in the summer of 1841 at a special session, and since it was not to be enforced until February 1, 1842, ample opportunity was given to repeal it before it went into effect. It was claimed that on one day it was laid on the table by a majority of 11, and the following day after a night when the wine flowed freely, it was taken from the table and passed. It was claimed also that the friends of the bankruptcy Act held up the Land Distribution Bill and prevented the passage of the latter act until after the former had been passed. The unsuccessful attempt to repeal the law before it went into operation did not hinder its opponents from beginning an early campaign for its repeal. They felt that the experiences of the summer and early autumn in which hundreds of those who were insolvent went through bankruptcy proceedings, would win to their side many of those who had been in sympathy with the law. The undue haste in taking advantage of the law's voluntary features and in insisting on a discharge from debts, was responsible for the change in sentiment.

The constitutionality of the law again concerned the members of Congress. The chief points of attack in this regard were its voluntary and retroactive features. The law was objected to in these respects, not only on constitutional grounds, but in the interests of public policy.

It was argued that the law was unconstitutional on account of its retroactive features. One senator (Benton of Missouri) argued that the discharge of a debtor without the consent of creditors or a certain percentage of them was unconstitutional, and was not the practice of any of the progressive countries which have bankruptcy laws. The same authority held that the voluntary provisions interfered with the insolvency laws of the states and was on this account, unconstitutional. It was claimed that the Constitution of the United States gave Congress the power to pass bankruptcy and not insolvency laws. It was also claimed that the right of states to pass lien laws was paramount and this right was prohibited by the National Act.

Arguments
that the
law was
unconsti-
tutional.

On the other hand, it was argued that it was too narrow a construction of the Constitution to limit the power of Congress in bankruptcy legislation to the kind of a law England had when the Federal Constitution was adopted. A progressive state would allow some elasticity in legislating under the Constitution. It was also maintained that one cannot draw a hard and fast line between an insolvent and a bankrupt law. In general, an insolvent law discharges the person of a debtor only, while a bankruptcy law is more general, and may not only discharge the person of a bankrupt but also free him from the payment of his debts after he has surrendered all his property to pay his debts. It was also asserted that the legal requirement for the consent of a majority of creditors in number and in value to discharge a debtor, was

unnecessary from a constitutional point of view. These arguments on the constitutionality of the bankrupt law were made in apparent ignorance of the Supreme Court decisions above referred to.

Some of the opponents of the law insisted that it had been responsible for all kinds of injustice, inequality, and fraud and for these reasons it should be repealed as soon as possible. It was maintained that many who had heretofore been solvent were ruined by relieving their debtors from the liability to pay their debts.

Those who opposed the repeal of the law held that its evils could be traced chiefly to its retroactive features. Some claimed that it should be amended by repealing its voluntary provisions.

Strength

of the law.

Others argued with a great deal of wisdom that the worst evils of the law had already been experienced, and that if it were repealed now, the chief sufferers would be those who were made insolvent by the undue haste with which their debtors went through the bankruptcy court, and who were consequently reduced to bankruptcy by the law itself.¹ The opponents of repeal contended that these people should now be given a fair chance to secure the benefits of the Bankruptcy Act themselves. It was claimed that at this time the law would be administered primarily with respect to prospective cases, those with which the law should ultimately deal. It was held, moreover, that those who would vote to repeal the law would be responsible for future retroactive legislation with all the abuses which such legislation

¹ See address, Buchanan of Pennsylvania, A. D., Vol. 14, p. 713.

entails. The sentiment favoring repeal was too strong at this time, and no argument could withstand it.

The preamble¹ to the bill providing for the repeal of the law introduced in the Senate by Mr. Benton on December 7, is as follows: "Whereas the Repeal. Bankrupt Act of 1841 is unconstitutional and immoral, and violates the rights of the states and of individuals, and is invalid and void, and ought not to be permitted to remain on the Statute-book."

The bill which passed the House permitted the cases which were pending to take their course under the law.² "The repeal shall not extend to or affect any case which, at the time this Act goes into effect, shall be pending before any court; nor to any proceeding which, at said time, shall have been in progress, under and by virtue of the said Act hereby repealed."³ The motion to repeal passed the House by a vote of 140 to 71.

When the House bill went to the Senate, a motion was offered by Senator Benton striking out the above section which permitted all bankruptcy cases pending when the Act was repealed, to be settled in accordance with the law. His amendment substituted certain clauses that were in the Senate bill he introduced, clauses that followed closely the methods of closing estates provided by the law of 1800.

¹ Benton's speech, A. D., Vol. 14, p. 610.

² Abridged Debates, Vol. 14, p. 658.

³ Prior to this vote a motion to amend the Bankruptcy Act by repealing the voluntary features was defeated by a vote of 136 to 73.

These required the consent of two-thirds of one's creditors for a discharge, that the insolvent laws and the lien laws of the states remain in force, that a person subject to involuntary bankruptcy should not have the privilege of voluntary bankruptcy, and that the operations of the law be prospective only. In the discussion it was claimed that the amendment requiring changes in legal procedure for pending cases would cause a great deal of confusion, and that the repeal of the law which they thought was imperative at this time would be delayed and would possibly be defeated by the fact that the law was sent back to the House. The amendment was defeated and the House bill was passed by a vote of 32 to 13. The law was repealed with the exception that cases already pending were to be settled according to the provisions of the law.

CHAPTER XVIII

BANKRUPTCY ACT OF 1867

FOR twenty-four years after the repeal of the National Bankruptcy Act in 1843 the country was without a bankruptcy law. Within this period the friends of National bankruptcy legislation had before Congress various bills, all of which were rejected. A National Bankruptcy Act was on the program of the Pierce Administration in 1853. In 1864 an unsuccessful effort was made by Congressman Thomas A. Jenckes of Rhode Island, a champion of bankruptcy legislation to secure the passage of a law. Since the sentiment favorable to such legislation is always strongest after periods of industrial depression, the settled conviction was reached at the close of the Civil War that the time for a National Bankruptcy Act had arrived. The debates on this subject in Congress in 1866-67 show that the form of the Act was the only subject in question.

The first Bill introduced in the House after the war, was defeated March 28, 1866, by a vote of 73 to 59. However, a motion to reconsider the measure was soon afterward passed by a vote of 83 to 45. This measure provided for both involuntary and voluntary bankruptcy, and according to its provisions a large body of marshals and other officers were required to enforce the

*Agitation
for a third
bankrupt
law.*

*A bank-
rupt
measure
defeated
in 1866.*

law. This latter feature was objectionable to many, others opposed the extension of the involuntary provisions to all classes, and still others objected to the laws retroactive features. It was claimed in the debate that if the proposed Bill became a law a "swarm of office holders would swoop down on the estates of bankrupts, and nothing would be left for the creditors."¹ The same speaker insisted that Congress was not asked for a compulsory Bankrupt Act, and that it would be a great injustice to inflict compulsory bankruptcy on mechanics and farmers.

Congress was asked to pass a law to relieve unfortunate debtors from the obligation of paying their debts with

Should the exemption laws of the states be abolished by a new Bankrupt Act?

future earnings, since a provision for this purpose was considered of paramount importance. The House was at first opposed to any interference with the exemption laws of the states, which as they stood left the debtor a minimum amount of property after going through insolvency proceedings. On this subject the

Senate and House clashed. It was claimed in the House that contracts between debtors and creditors were made with a full knowledge of the exemption laws of the states, and that no harm could come to a creditor if these laws of the states were observed in the National Bankruptcy Act. It was argued, moreover, that the national government did not have the constitutional right to set aside the exemption laws of the states. In the Senate it was held that a recognition of

¹ Speech, Rep. Paine: Congressional Globe, 1865-66, Part 2, p. 1689.

the exemption laws of the states would defeat uniformity in bankrupt legislation and practically incorporate the exemption laws of the states into the National law. It was urged too that the annulment of these laws of the states would not work an injury to debtors, since the latter would receive something from the National Act in the form of a discharge from future debts, a discharge which could not be granted by the states in any of their laws.

The sectional question, which at this time was extremely bitter, played a part in the discussion. Creditors of northern cities petitioned Congress to pass a National Bankruptcy Act to assist them in collecting debts in the South. The most valuable property of the South was in estates, and the southern land owners were influential in the state legislatures. It was claimed that if creditors should fail to collect claims in state courts, they would succeed in the United States Courts under a national bankrupt law. The sectional feeling was still further reflected in the views of some northern congressmen, of which Charles Sumner was a conspicuous example, who were in favor of denying voluntary bankruptcy to those whom they termed rebels.¹

The
secional
question
in the
proposed
law.

A compromise measure was agreed upon which passed both Houses and was signed by the President in 1867. Like its predecessor, it provided for both voluntary and involuntary bankruptcy, but unlike its predecessor, it extended the involuntary provisions to all classes of bankrupts.

A com-
promise
measure.

¹ Congressional Globe, 1867, Part 2, p. 169.

The District Courts of the United States were given jurisdiction in their respective districts in all matters

District Courts of the United States given jurisdiction in the Act of 1867. pertaining to bankruptcy, and they were required to be open at all times for the transaction of business under this Act. These Courts were given power to hold their sessions at any place in the district, after having given adequate notice. This provision was intended to correct defects in the two preceding laws,

defects arising from the inconvenience of creditors and witnesses in attending sessions of the court. The Circuit Courts of the United States were given "a general superintendence and jurisdiction of all cases and questions arising under the Act; they were also given the power to hear cases as a court of equity upon petition or other regular process." An amendment to the law in 1874 gave the Circuit Courts concurrent jurisdiction with the district courts in all cases at law or equity brought against the assignee in bankruptcy, or by the latter against any person having an adverse interest with reference to the property or property rights of the bankrupt.

ADMINISTRATION OF THE LAW

It was made the duty of the judges of the District Courts to appoint in each congressional district, upon **Duties of District Courts and Registers.** the recommendation of the Chief Justice of the Supreme Court, one or more registers in bankruptcy "to assist the judge of the District Court in the performance of his duties under

this Act." The register was required "to receive the surrender of a bankrupt, to administer oaths in all proceedings before him, to preside at meetings of creditors, to take proof of debts, to make all compilations of dividends, and all orders of distribution, and to furnish the assignee with a certified copy of such orders, and of the schedules of creditors and assets filed in each case." He was also required to audit and pass on the accounts of assignees, and to do such administrative business of the court as the district judge should direct. He was to keep memoranda of the proceedings coming before him and to forward to the clerk of the District Court a certified copy of these memoranda. The judge of the District Court could require the register to go any place within the district for the purpose of performing the various functions of his office. All cases in equity could be appealed from the District Courts to the Circuit Courts, but no cases could be appealed from the Circuit Courts to the Supreme Court unless the matter in dispute exceeded \$2,000. This Act was amended in 1874 with reference to the latter provision, so that no case could be appealed from the Circuit to the Supreme Court unless the amount at issue exceeded \$5,000.

In the provisions stated above is found another attempt to bring the bankruptcy court within easy access of the people. The registers to be appointed were to be lawyers, and they were to have almost complete charge of cases in bankruptcy. As one was to be appointed in each legislative district and as the register could be required

Attempt
to make
the courts
convenient
to the
people.

to hold his court at any place within the district, the arguments against the former laws with reference to the expense and inconvenience in attending these courts could not be applied with equal force to the Bankruptcy Act of 1867.

The law which first passed the Senate required the circuit judges to appoint the registers upon the recom-

Reasons why district judges should appoint registers. recommendation of the Chief Justice of the Supreme Court. This provision was amended in the House by placing the obligation to appoint registers on the district judges. When the House amendment returned to the Senate, it provoked a great deal of discussion, which showed that partisanship had much to do in determining where the appointing power should be placed. In favor of the House Amendment it was claimed that since the district judges have charge of the cases in bankruptcy, and the registers work under them, the latter should be appointed by the former. It was claimed, moreover, that the district judges would know the members of the bar from which the appointments must be made, whereas the circuit judges could not in the nature of things know the lawyers, and the appointments would be dictated by politicians. It was thought that the office of Chief Justice of the Supreme Court would be degraded by making the Chief Justice responsible for partisan appointments.

On the opposite side it was argued that the district judges were amenable to the circuit judges, and that the registers, who were subordinates of district judges,

should be also under the authority of the Circuit Judge. It was claimed that as the Chief Justice of the Supreme Court is the head of the judicial system of the United States, the appointment of officers of the court by him would not degrade his office any more than the appointment of government employees by the President of the United States degrades the latter's office. A compromise was finally reached, which placed the appointment of the registers in the hands of the district judges upon the recommendation of the Chief Justice of the United States.

Reasons
why
circuit
judges
should
appoint
registers.
Compro-
mise
adopted.

VOLUNTARY BANKRUPTCY

Any person owing debts to exceed \$300 might apply for the benefits of this Act to the judge of the Judicial District in which the debtor resided for six months previous to filing the petition, by stating his place of residence, his inability to pay his debts, and his willingness to surrender all his property for the benefit of his creditors. The requirement that the debtor must owe \$300 before he could go into bankruptcy was intended to prevent those who owed small amounts incurred chiefly by living beyond their means, from cancelling their debts. The debtor was required "to annex to his petition a schedule verified by oath before the Court" or before an agent of the court giving a full statement of all his debts, the names of his creditors, there places of residence, the nature of each debt, and the manner by which it was incurred.

Who
might
become
voluntary
bankrupts.

He was required to give also a statement of any existing mortgage or pledge given for payment in case there was either of such in existence. The filing of this petition was considered an act of bankruptcy, provided that the applicant took an oath of allegiance to the United States and that the court was convinced that the debtor owed debts in excess of \$300.¹ The judge was required to order such notices published in the newspapers as the warrant prescribed. He was required also to cause a written or printed notice to be sent by mail or by messenger to the creditors to the effect: (1) "That a warrant in bankruptcy has been issued against the estate of the debtor; (2) that the payment of any debts or the delivery of property to the debtor or the transfer of any property is forbidden; (3) that a meeting of the creditors of the debtor will be held to prove their debts at a court of bankruptcy, to be held at a specified time not less than ten nor more than ninety days after the issuing of the warrant."

The creditors were required to elect, at their first meeting, one or more assignees of the debtor's estate.

**Selection
of
assignees.
Property
left with
bankrupt.** The choice was to be made "by the greater part in value and in number of the creditors who have proved their debts."² If the assignees were not chosen at this meeting the register might appoint them if there was no opposition, and the district judge might ap-

¹ This clause was for the benefit of those who shortly before had participated in the secession movement.

² Section 12, The Bankruptcy Act of 1867.

point if he chose to do so; but he *must* appoint the assignees if there was opposition to their appointment by the register. The approval of the judge was necessary to the election or to the appointment of an assignee. As soon as the assignee was appointed "the judge shall (or where there is no opposing interest the register may) convey to the assignee all the property and property rights of the bankrupt with the following exceptions:" (1) The necessary household and kitchen furniture, and such other necessities of the bankrupt as the assignee might designate taking into account the circumstances of the family, but the whole amount was not to exceed \$500. (2) "The wearing apparel of the bankrupt, and that of his wife and children."¹ (3) "The uniform, arms, and equipment of any person who is or has been a soldier in the militia or in the service of the United States." (4) Such property as was exempted from seizure, attachment or "levy on execution by the laws of the United States." (5) Other property not included in the foregoing exceptions, which was exempted from levy in the payment of debts by the state where the bankrupt resides, "to an amount not exceeding that allowed by such state exemption laws in force in 1864."

The assignee was given power to dispose of the property of the bankrupt to the best interest of the creditors. An account of all money received by him as assignee was to be kept, which account any creditor might examine at any reasonable time. He was also given the same rights to collect

Duties of
assignees.

¹ Section 14, The Bankruptcy Act of 1867.

debts owed the estate of the bankrupt as the debtor would have in the absence of bankruptcy proceedings.

The court might require its bankrupt to submit to an examination under oath regarding all matters pertaining to his property, its condition, his accounts, etc. The court might also require the attendance of any other person for a similar investigation. The wife of the bankrupt might also be required to attend court to be examined as a witness and if she refused, the bankrupt's discharge was to be denied unless the latter proved to the satisfaction of the court that "he was unable to procure the attendance of his wife."

The following debts were entitled to priority, each to be paid in full in the following order: (1) The costs of closing up the estate; (2) debts owed the United States including all taxes and assessments; (3) debts owed the state and taxes and assessments under the laws of the state; (4) wages due an operator, clerk or house servant not to exceed \$50 for labor performed within six months of the time of the first publication of proceedings in bankruptcy; (5) all debts due any one who by the laws of the United States is entitled to preference.

DISCHARGE

Any time between six months and a year after the adjudication in bankruptcy the debtor may apply for a

discharge from his debts. The court is then required to give notice by mail to all creditors and to publish a notice once a week in newspapers having a general circulation in the district, calling a meeting of creditors to show why the debtor shall not be discharged. Here follows a long list of things which will prevent a bankrupt from securing a discharge, of which the chief ones are: (1) Swearing falsely regarding any matter pertaining to his estate; (2) concealing a portion of his estate or any of his records or falsifying his records; (3) giving a preference within four months previous to the beginning of proceedings in bankruptcy or making a fraudulent assignment of his property; (4) losing a part of his property in gambling; (5) admitting a false or fictitious debt against his estate, or failing to disclose the fact that such a debt had been proved; (6) failing as a "merchant or tradesman" to keep proper books of account.

No person discharged under this Act can be discharged a second time on his own petition if his assets do not pay 70 per cent. of his debts, unless three-fourths in value of his creditors who have proved their claims give their consent in writing to his discharge. Any bankrupt, however, who has proved to the satisfaction of the court that he paid all his debts at the time of his previous bankruptcy or who has been released voluntarily by his creditors, may be discharged under the same conditions as if he had not been a bankrupt previously.

What prevents a discharge.

Conditions determining a second discharge.

An amendment was before the Senate requiring as a condition necessary to a discharge that the assets of a bankrupt should pay 50 per cent. of his debts, or else that a majority of his creditors should vote for his discharge. This amendment was opposed on the ground that its acceptance would defeat the Bill. The interests of those who desired a discharge from debt were so strongly represented in Congress, that its defeat was inevitable. At this time a requirement that 50 per cent. of the debts should be paid would exclude from the privileges of discharge all but very exceptional bankrupts.

INVOLUNTARY BANKRUPTCY

A person might be made an involuntary bankrupt for any one of the following reasons: (1) Absenting himself

Who may be made an involuntary bankrupt. from the state or territory where he lives or concealing himself to defraud his creditors; (2) concealing or removing his property, giving away or disposing of it, to defraud or delay action on the part of his creditors; (3) while insolvent or in contemplation of insolvency disposing of or transferring his property with intent to prefer creditors or otherwise to defeat the operations of the law; (4). committting an act of bankruptcy and being adjudged a bankrupt on petition of one or more creditors whose total debts amounted to at least \$250, provided the petition was filed within six months of the act of bankruptcy.

When a petition was filed to make a debtor a bankrupt, if the evidence was sufficient the court might order the

debtor to appear before it to show why he should not be made a bankrupt. If the petitioners could not establish their charges the debtor was to be dismissed, and he had the right to collect damages. If the charges preferred in the petition were found to be true, the court should adjudge the debtor a bankrupt and was required immediately to issue a warrant for the taking possession of his property. The property should be taken, disposed of, and distributed in the same manner as if the debtor became a bankrupt on his own petition.

At a meeting of the creditors, three-fourths in value of the creditors whose claims had been proved might decide what action should be taken in the interests of the creditors with reference to the estate of the debtor. They might decide that the estate should be settled and divided among the creditors by trustees, under the direction of a committee of the creditors, the creditors to have the right to nominate one or more trustees to close the estate. However, the sanction of the court when it deemed that the interests of the creditors would be promoted by this action, was necessary. When three-fourths in value of the creditors whose claims had been proved filed their consent that the estate of the bankrupt be wound up and settled by the trustees, it became the duty of the bankrupt or his assignee to transfer the estate to the trustees, the latter having the same power in holding and disposing of the property as the assignee would have had if the resolution of the trustees had not been passed.

A petition
to make a
debtor a
bankrupt.

Control of
debtor's
estate by
creditors.

The bankrupt in involuntary proceedings had the same right to petition for a discharge in bankruptcy and was entitled to the same treatment as if he became a bankrupt on his own initiative.

All the fraudulent acts which made a debtor an involuntary bankrupt made him guilty of a misdemeanor, and upon proof of this in any court of the United States he might be imprisoned for not more than three years.

**Punish-
ment for
a mis-
demeanor.**

At the outset the law was acceptable to both debtors and creditors. It had been carefully drawn after the best models. The chief models used in framing the laws were the Insolvency Law of Massachusetts and the Bankruptcy Act of England. Unforeseen defects appeared in practice, and it proved much more unsatisfactory than either of the former laws. An English Act of 1831 established a system of officials to handle the cases of bankrupts, and this law was not repealed until 1869.

**Modeled
after the
law of
Massa-
chusetts
and the
English
Bankrupt
Act.**

This Act provided for a court of review, composed of a chief judge and three junior judges, to take charge of bankrupt cases. Thirty official assignees were appointed to act with creditor assignees. The machinery for closing estates was cumbrous, slow, and expensive, and proved very unsatisfactory.

The American Act of 1867 proved even more unsatisfactory than the English law. The methods of closing estates were slow and expensive, and the courts were not held at places where they were easy of access by the

people. The law would have been repealed long before 1878 if it had not been for the disturbed industrial conditions of the United States. The compensation of all officers and attaches of the court was in fees, and the earnings of each officer were not in proportion to his services. The failure to limit definitely the work of each official for which fees might be received made the costs of closing an estate subject to the desires of the officers who had it in charge. The answer of an English candidate for admission to the bar to the question "What is the province of the courts in bankruptcy?" seemed to state quite accurately the conditions under which the Bankruptcy Act of 1867 operated, viz., "To see the estate of the bankrupt equally divided between the officers of the court and the attorneys engaged in the cause."

Defects of
the Act of
1867.

The law presupposed the appointment of high grade lawyers as registers. Instead of these, broken down politicians and men who were failures in the practice of the law were frequently appointed. Although the duties of the registers were limited and their powers were restricted, means were devised to extend these powers and increase their fees.

In case this was done a voluntary petitioner would bring his schedule to the register, the latter would induce him to change it under the assumption that it was not made out properly for which he would receive a fee; he received another fee also for giving an oath. In proving his claims the creditor would be induced to change his affi-

Class of
registers
appointed.
Methods
employed
to make
the closing
of estates
expensive.

davit for which the register would receive fees. When the creditor could not attend a meeting of creditors, he had to give a power of attorney, for which the register received another fee. In taking proofs the register found other ways of securing fees. When proofs were objected to, the objection had to be put in writing; a time and place were assigned for hearing cases, and another opportunity was presented to the register to increase his income. The register and assignee frequently worked together, and the former was in a position to help the latter to secure an income much above what the law assumed he would receive. The marshal and clerk of the court were also permitted to receive exorbitant fees for the labor they performed. The system of the court officials to secure the bulk of the bankrupt estate was such that in a few years most creditors decided to settle their claims out of court.

An amendment was passed in 1870 which provided that any one "who stopped or suspended and had not resumed the payment of commercial paper within a period of fourteen days" could be proceeded against as a bankrupt. With the panic of 1873 many influential creditors saw that they might become debtors at any time, and that under the above amendment they could be proceeded against for the suspension of the payment of commercial paper. Their influence was at once exerted to modify the involuntary provisions of the bankruptcy law. In his message to Congress in 1873, President Grant pointed

The amendment of 1870.

out some of the weak points in the law that would make themselves felt in a period of commercial depression, and recommended either the entire repeal of the law or else the repeal of the involuntary provisions. He claimed that the involuntary provisions continued to embarrass the country; that in times of monetary stringency even prudent business men were made bankrupts although their assets might exceed their liabilities; and that this country had gotten into such a nervous state that the filing of a petition by an unfriendly creditor often ruined responsible business men.

The important changes introduced in the bankruptcy law of 1867 by the amendments of 1874 had to do with changes in the involuntary features, and the provision for settlement out of court.

The Act of 1867 as amended in 1870 made the suspension of payment of commercial paper for fourteen days by a banker, merchant or trader a reason for action in involuntary bankruptcy. An amendment of 1874 made the fraudulent stopping of payment or the suspension of payment in the ordinary course of business for forty days a cause for action in involuntary bankruptcy.

Amend-
ment of
1874.

Under the Act of 1867 a debtor could be adjudged a bankrupt upon petition of one or more creditors if their debts aggregated \$250. This clause was amended in 1874 so as to require the petition to make a debtor a bankrupt to come from at least one-fourth of the creditors whose debts amounted to at least one-third of the provable debts of the bankrupt. In all cases where

action was initiated by petitioners not in conformity with this amendment, the cases were to be dismissed at the expense of the petitioners.

This amendment practically repealed the involuntary provisions of the law. The risk to the creditors in all

The Amend-
ment of
1874
weakened
the in-
voluntary
law.

but very exceptional cases was entirely too great for them to take action to throw a debtor into bankruptcy. It was claimed that no one could be made an involuntary bankrupt except by his own consent. An involuntary bankrupt received his discharge more easily than one who sought voluntarily for the benefits of the law.

By a perverse ingenuity the law was so constructed that it was to the interest of the debtor to be made an involuntary bankrupt, although the creditor preferred that the debtor go into bankruptcy voluntarily.

The suggestion for the other important change in the law of 1867 came from the English law of 1869 providing for settlements outside of court.

A second amend-
ment of
1874
enabled
estates to
be settled
out of
court.

This provision enabled the debtor to offer terms of composition which, if accepted by a majority in number representing three-fourths in value of the creditors at a meeting called by the court, and if confirmed by the signatures of the debtor and two-thirds in number and one-half in value of the creditors, became binding.

The debtor or a representative of him was required to be present at this meeting and "produce a statement showing the whole value of his assets and debts

and the names and addresses of the creditors to whom such debts respectively are due."

Since the law of 1867 and the preceding laws were modeled to a certain extent after the English laws, it was quite natural for us to go to the English amendments of 1869 for suggestions when an amendment of the law of 1867 was contemplated. The English law of 1869 permitted the debtor to petition for the liquidation of his affairs by arrangement, or by offering directly to his creditors terms of composition. The latter method is simpler and less expensive than the one described in the preceding paragraph. The debtor offers to settle at so much on the dollar, and if his offer is accepted by his creditors, he is discharged. This law left matters to too great an extent in the hands of debtors in that they were permitted to pursue the practice of going among creditors to obtain proxies before a meeting was called and before concerted action could be taken. No definite control was exercised over the debtor's statement of his assets and his liabilities, and consequently this route to settlement became the recourse of the dishonest. Settlement by composition in England became a failure.

English
method of
settling
estates
out of
court.

In the United States a difference of opinion prevailed as to the value of settlements by composition. Settlements were made at much less expense than that required by going through bankruptcy, and the extraordinary abuses reached in England in settlements by composition did not prevail here. However, the law in the United States did not protect creditors by adequate

safeguards against fraudulent debtors by requiring a careful examination of their books and a thorough examination of their affairs before accepting their terms of composition.

The amendments of 1874, instead of improving the law, had only made matters worse. At the session of

**Elements
of
weakness
in the
amend-
ments of
1874.** Congress in which the amendments were passed the House was in favor of a repeal of the bankrupt law. In 1876 the sentiment within the House was so overwhelmingly against the law that the House voted to repeal it without debate. A memorial requesting its

repeal gives us some clue to the arguments which influenced the members. It was claimed that fraudulent preferences were not prevented by the law, that large debts were often incurred with the expectation of compromise, that the closing of estates was unreasonably prolonged, and that the expenses of settling estates discouraged bankruptcy proceedings altogether.

A bill providing for the repeal of the law was introduced by Senator MacCreery of Kentucky, October 17,

**A bill to
repeal the
law.** 1877. It was submitted to the Judiciary Committee, which reported favorably for repeal April 10, 1878. In introducing the bill Senator MacCreery said that "the only ones who will regret the repeal are those who have fattened on the fees and those getting ready for its advantages."

The legislators at this time were divided into three camps: 1. Those who wanted the law amended; 2. those who wanted immediate and unconditional repeal;

3. those who desired the repeal of the law but who wished a delay of the repeal of the voluntary provisions until January 1, 1879. The extremes to which we had gone in bankruptcy may be seen from the fact that every one was in favor of an immediate repeal of the involuntary portion of the law. When the repeal of the law of 1841 was up for consideration, the voluntary provisions of that law were aimed at chiefly as they were considered unconstitutional and dangerous to industrial stability.

Diverse views of members of Congress on bank-ruptcy.

Senator Matthews of Ohio introduced an amendment repealing the law of 1867 but substituting a simple law abolishing involuntary bankruptcy and making possible a discharge in voluntary bankruptcy when the assets paid 50 per cent. of the debts. It was provided that a discharge should not be extended to what had been acquired fraudulently or to obligations that had been incurred by means of a breach of trust. After much discussion this amendment was rejected. It was claimed that the amendment should go back to the Judicial Committee, a process which would delay action, and Congress was in no mood to postpone the time for the repeal of the law.

An act to repeal the Involun-tary Law.

Much difference of opinion prevailed on the postponement of the time when the repeal of the voluntary provisions of the law should take effect. Those favoring postponement felt that some time should be given for the adjustment of affairs to the new conditions, and some time for those

Time at which the repeal bill should go into effect.

contemplating bankruptcy to begin action. Those opposed to postponement contended that delay would cause a demoralization in business by the great rush of prospective bankrupts to the bankruptcy courts.

Some of the prominent members of the Senate believed that a national bankruptcy act would be superior to the insolvency laws of the various states, and although they admitted that the law of 1867 was a failure, they hoped that it might be amended so as to meet the approval of members of Congress. The difficulties in the way of preparing a satisfactory law to satisfy the industrial conditions in the various states were pointed out. It was contended that the framing of a satisfactory law for England was a difficult thing. This was to be seen in the fact that although she was a commercial nation and did not enjoy the variety of industrial interests possessed by the United States she made frequent changes of the bankruptcy law. By a large majority in both Houses, the bill was finally repealed to take effect at once, with the exception that cases in process of settlement were not to be affected by the repeal.

In the eleven years the law was in force over 100,000 bankrupt cases were considered. The distribution of these cases shows that commercial interests in any section of the country determine the importance of the law to it. One district of Florida had in all these years but one case, whereas Massachusetts alone had 9,000 cases.

The law proved a failure because of the costs of settle-

Law
repealed
to take
effect at
once with
exception
of cases in
process of
settle-
ment.

ments, delays in closing up affairs, the inaccessibility of the courts, and the failure of the involuntary provision by the Amendment of 1874. The law died of these diseases, says a critic: "fees, obstructions to involuntary proceedings, and compositions." Opinions differ with reference to compositions, but all were agreed that costs in settling estates and the shortcomings of the involuntary provisions were important factors in defeating the law.

Why the
law was a
failure.

If the officials of the court had been paid salaries instead of fees and if penalties had been imposed when estates were not settled within a given period, the law would have been greatly improved. It was made too easy to go into bankruptcy and too difficult to force an unwilling debtor into bankruptcy and bring about a proper disposing of his estate. The United States courts were too inaccessible, and lawyers and others did not seem to be familiar with the workings of the law. It is always easier to repeal a bad measure than to correct its defects, and therefore the easiest policy was pursued by Congress.

CHAPTER XIX

BANKRUPTCY ACT OF 1898

THE law of 1867 would have been repealed before 1878 if it were not for the fact that a large class of business men believed that the class of interests they represented would be best served by a national bankrupt law. They consequently hoped that the law of 1867 might be amended in such a way as to eliminate its worst features. Shortly after it was repealed a campaign was started by them for the purpose of enacting a national law, which they hoped would be permanent. National conventions were held in Washington in 1881 and 1884, in St. Louis in the spring of 1889, and in Minneapolis in the fall of 1889. Believing that the fundamental weakness of the law of 1867 consisted in its administrative features, that is, in the unnecessary delays and in the great costs in closing up estates, and in the inaccessibility of the federal courts, they at once proceeded to frame a law in which these defects would be eliminated. Representing commercial and business interests they were naturally concerned chiefly in raising the plane of credit and consequently in having a strong involuntary law. The first two conventions approved a Bill framed by Judge Lowell of Massachusetts. It was believed to be too severe on debtors, however, and finally at the Minneapolis convention the

so-called Torry Bankrupt bill, containing less drastic features than the Lowell, was approved.

In accepting this measure the convention had in mind (1) the rights of the creditors, to the extent of giving them ample protection against the dishonest debtors, and preventing the latter from being discharged; (2) the rights of the debtor to the extent of giving liberal remedies in voluntary bankruptcy and protecting the honest from persecution; (3) the need for a law that would be in every respect national in its scope, inexpensive, and as simple as possible in its operation.

The measure proposed by the Minneapolis convention was amended frequently. It passed the House in the Fifty-first Congress, was defeated there in the Fifty-third Congress, and was passed again in the Fifty-fourth Congress. A voluntary bankruptcy measure introduced by congressman Bailey of Texas, passed the House in the Fifty-third Congress but was not submitted to a vote in the Senate. In the first session of the Fifty-fifth Congress practically the same measure passed the House by a majority of 76.

In the second session of this Congress the measure which passed the House, and which became with the amendments of the Senate the National Bankrupt Act of 1898, was introduced by Congressman Henderson, and was the original Torry Bill with amendments.

The author in speaking for the measure claimed that it would accomplish the following objects: "(1) Treat

Purposes of the proposed measure.
Efforts to pass the Bill proposed by the business men's convention.

What it was claimed that the measure would accomplish. the honest bankrupt with consideration and in a reasonable time discharge him; (2) punish in a human way dishonest bankrupts; (3) reduce the estate of a bankrupt to cash quickly and give it to the creditors; (4) give creditors a hearing at each stage of the proceedings; (5) substitute inexpensive compromises for expensive litigation."

Voluntary bankruptcy. Under this law all debtors except corporations could petition to become voluntary bankrupts. Each petitioner in voluntary bankruptcy was required to file a schedule of his property under oath, giving in detail a list of creditors, the amounts due each, and the security held by them. He was required to surrender all his property aside from what the exemption laws of his state permitted him to keep, while his creditors were to take control of his property and to distribute the dividends. Judges or referees could make adjudications or dismiss petitions. Fraudulent conveyances could be recovered, and if the bankrupt committed an offense punishable by this Act he could be tried in another court for a criminal offense. The estates of voluntary and involuntary bankrupts were to be administered in precisely the same way, and the rights of the two classes of bankrupts were identical.

Involuntary bankruptcy. All debtors except farmers, wage earners, and national banking institutions owing debts in excess of \$1,000 could be made involuntary bankrupts. The petition must allege one or more acts of bankruptcy, which include insolvency, inability

or unwillingness to pay debts or to keep property from getting away by preferences.¹ The title of the trustee begins with the date of adjudication but the condition of the property relates back to the time of filing the petition and the bankrupt is in precisely the same position as any defendant in law or equity proceedings.

A petition to make a man a bankrupt may be filed within four months after the commission of an act of bankruptcy. "Such time shall not expire until four months after the date of the recording or registering of the transfer or assignment when the act consists in the debtor's having made a transfer of any of his property with intent to hinder, delay or defraud his creditors; or for the purpose of giving a preference as hereinbefore provided, or a general assignment for the benefit of his creditors, if by law such recording or registering is required or permitted, or, if it is not, from the date then the beneficiary takes notorious, exclusive, or continuous possession of the

Petitions
in invol-
untary
bank-
ruptcy.

¹ "Acts of bankruptcy by a person shall consist of his having (1) conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, any part of his property with intent to hinder, delay, or defraud his creditors, or any of them, or (2) transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors; or (3) suffered or permitted, while insolvent, any creditor to obtain a preference through legal proceedings, and not having at least five days before a sale or disposition of any property affected by such preference vacated or discharged such preference." Five acts of bankruptcy were enumerated by the law, two of which were voluntary acts of bankruptcy.

property unless the petitioning creditors have received actual notice of such transfer or assignment."¹ A settlement may be made between debtors and creditors after the debtor has been examined in open court or at a meeting of his creditors.

A bankrupt must petition for a discharge not sooner than one month or later than one year after adjudication.

Petitions in involuntary bankruptcy. In exceptional instances the time of filing the petition may be extended six months. He must be discharged unless he has been found guilty of dishonesty or fraud with reference to his property. The confirmation of a composition discharges the bankrupt from all debts except those which were agreed to be paid by the terms of the composition.

The Nelson Bill, primarily a voluntary measure, passed the Senate, and the matter of bankruptcy was submitted to a joint committee of both House and Senate.

The bill which passed was a compromise measure. The measure adopted was known as the Henderson Bill because the law which finally passed was, from an administrative or procedure point of view, the House measure. However, it will be seen that this measure was in principle more nearly the Senate Bill than the House measure. The two measures differed chiefly on (1) grounds of involuntary bankruptcy, (2) offenses for which a bankrupt could be imprisoned, and (3) restrictions to be placed on a discharge.

¹ United States Bankruptcy Law of 1898, Ch. 3.

The House Bill¹ stipulated nine grounds for denying a bankrupt a discharge. These were reduced by the conference committee to two: (1) Committing an offense punishable by indictment; and (2) keeping fraudulent books. The four grounds on which a bankrupt could be imprisoned in accordance with the provisions of the House Bill were changed to two by the conference committee: (1) concealing property from the trustee; and (2) committing perjury by making a false statement.

The law which passed both Houses of Congress and was signed by the President, July 1, 1898 defines courts of bankruptcy as follows: the District Courts of the United States in the several states, the Supreme Court of the District of Columbia, the district courts of the several territories, and the United States Courts in the territories. The courts have the power to try and to punish bankrupts or to discharge them, "to confirm or reject compositions between debtors and creditors," to appoint receivers or marshals to take charge of the property of bankrupts upon application of those interested, and to authorize them or trustees to manage the property for limited periods in the best interests of the estate, and "to cause the estates of bankrupts to be collected, reduced to money, distributed, etc."

Any one of five acts makes a man a bankrupt: (1) Concealing or removing his property with intent to

¹ Congressional Record, Vol. 31, Part 7, p. 6296, Fifty-fifth Congress, second session.

Grounds
for
denying a
discharge.

Courts of
bank-
ruptcy
provided
by Act of
1898.

defraud his creditors; (2) While insolvent transferring his property with intent to prefer creditors; (3) While **Acts which made a debtor a bankrupt.** insolvent permitting a creditor to obtain a preference through legal proceedings without having discharged such preference at least five days before a final disposition of any property affected; (4) Making a general assignment for the benefit of his creditors; (5) "Admitting in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground."¹

Only the first three of the five acts come under the head of involuntary bankruptcy. Under this act a per-

When may a debtor be made an involuntary bankrupt. son is not considered insolvent if the aggregate of his property, exclusive of that which has been concealed or conveyed with fraudulent intent, is sufficient in amount to pay his debts. A fraudulent act of itself does not make a man a bankrupt. Even when dishonesty is established, if the alleged bankrupt proves his solvency under the above conditions the case must be dismissed, and the costs, including the fees of the attorney of the defendant, must be borne by those who bring the suit. To insure the payment of expenses, the petitioner must file a bond sufficient to cover costs.

Any one except a corporation may become a voluntary bankrupt, and any one except a wage earner and a farmer may be forced into bankruptcy. State or national banks cannot be adjudged bankrupts.

¹ See Amendments to the Act of 1898.

The bankrupt is required to attend the first meeting of his creditors, and he must "submit to an examination concerning the conduct of his business, the cause of his bankruptcy, the amount, kind, and whereabouts of his property, and all matters which may affect the settlement of his estate."¹ He is also required to obey all other lawful orders of the court, examine the correctness of all claims filed against his estate, and notify his trustee as soon as he learns of any attempt of creditors to evade the provisions of the Act.

A bankrupt may offer terms of composition to his creditors, after he has been examined in open court, at a meeting of his creditors, and after he files a schedule of his property and a list of his creditors, which the law requires. The bankrupt may apply for the confirmation of a composition when this application has been accepted in writing by a majority of his creditors representing a majority of accounts against him. The court is required to confirm a composition when it feels that it is to the best interests of the creditors, and it is satisfied that the bankrupt is not guilty of an act which would prevent his discharge. After one month and within twelve months after being adjudged a bankrupt, a person may apply to the court for a discharge. When the court has given all opposed to the discharge a reasonable opportunity to testify, it must discharge the applicant if it is satisfied that he has not committed an offense punishable with

Privileges
of a
bankrupt.

¹ United States Bankruptcy Law, 1898, Ch. 3, Section 7.

imprisonment or concealed his financial condition with fraudulent intent and, "in contemplation of bankruptcy, destroyed, concealed, or failed to keep books from which his true condition might be ascertained."

The bankruptcy law does not modify in the least the exemption laws of the states.

Courts of bankruptcy are required to appoint a sufficient number of referees so that each county may "constitute at least one district" when the services of a referee are needed. In the absence of a judge of bankruptcy, referees have all the powers of judges except the right to pass on the application of bankrupts for compositions and discharges.

Each county an administrative unit.

The creditors of a bankrupt estate at their first meeting may appoint one or three trustees to manage the estate. When the creditors do not appoint a trustee, the court is required to do so. The trustees may be either individuals competent to act as trustees, or corporations which are permitted either by their charters or by law to act in this capacity. The chief duties of the trustees are to control the estates in question, reduce the property to money, keep full accounts, and set apart the bankrupt's exemptions, dividends, etc. Trustees¹ may be allowed by courts "not to exceed 3 per cent. on the first \$5,000 or less, 2 per cent. on the second \$5,000 or part thereof, and 1 per cent. on such sums in excess of \$10,000."²

¹ Changed by the Amendment of 1903.

² United States Bankruptcy Law, 1908, Ch. 5, Section 48.

An important provision of the law is the prevention of preferences. Under this Act a debtor shall be deemed to have given a preference if, while insolvent, he has permitted or given a judgment against himself to some creditor, or transferred property to the latter, the effect of which will be to enable some creditor or creditors to receive a larger percentage of his debt than other creditors. If a debtor gives a preference within four months before the filing of a petition, or after the filing of the petition and before he is adjudged a bankrupt, and the person receiving it has reason to believe that it was intended as a preference, the trustee will have power to collect the value of the property from the one so preferred.

Prefer-
ences pre-
vented.

All taxes or debts "owing by the bankrupt to the United States, state, county, district or municipality" must be paid out from the proceeds of the estate before any dividends are paid to creditors. The debts which have a preferred claim to the assets of a bankrupt have priority in the following order: (1) The cost of preserving the estate after the filing of the petition; (2) "the filing fees paid by creditors in involuntary cases; (3) the cost of the administration of the estate, including reasonable fees to an attorney for the bankrupt in both involuntary and voluntary cases; (4) wages due workmen, not to exceed \$300 for each person, which were earned within three months prior to the commencement of proceedings; (5) debts owing to any person which by the laws of the states or the United States are entitled to priority."

Debts
which
have
priority.

The Torry Bankruptcy Bill was first introduced in Congress in 1890 and was presented to each succeeding congress until the law of 1898 was passed. **Con-**
trasted
interests
of debtors
and
creditors. The same set of circumstances which were responsible for former bankruptcy laws determined this law. The United States had gone through a period of industrial depression from 1893 to 1898, and hundreds of business concerns which had heretofore been prosperous were now bankrupts. As insolvents desire a law which will discharge them from their debts, a very different demand was made for the passage of a bankrupt law near the closing years of the panic than when the Torry Bill was first introduced in 1890. Debtors are naturally in favor of a voluntary bankrupt law, which will enable those who cannot pay their debts to go into bankruptcy and get a discharge from their obligations. The creditors, upon the other hand, are primarily interested in an involuntary law, since through it credit may be maintained on a high plane; they are interested in a voluntary law only to the extent that they desire the burdens lifted from the shoulders of honest debtors. The Torry Bill, since it was constructed by business interests for the purpose of elevating the plane of commercial credit, was supported mainly by commercial bodies in all sections of the country. The Bill which finally passed was the result of a struggle between the friends of the voluntary bankruptcy law and those of the involuntary and was consequently a compromise measure.

The chief opponents of the Torry Bill were the fol-

lowing: (1) The older business men who had had experience with the bankruptcy law of 1867, and as a result of that experience were convinced of the impracticability of any national law; (2) the larger business houses, which on account of their organization are in favor of the granting of preferences. (They have credit agents in all sections of the country who have an accurate knowledge of the financial status of the customers of the House. They know how much credit to give and the conditions under which credit should be granted. It is doubtful if such business concerns could be aided by a National Bankrupt Act which rigidly forbids preferences.) (3) the bankrupts and those primarily interested in having bankrupts discharged.

Chief
opponents
of the
Torry Bill.

From 1879 to 1906 there were 171,389 failures, representing liabilities of nearly three billion dollars. In the debates in Congress the condition of these unfortunates was vividly portrayed, and a vigorous appeal was made to pass a voluntary bankruptcy act which would enable these bankrupts to be discharged at once. To a certain extent the question was also made a sectional one. The chief advocates of the voluntary measures were from the South and the Mississippi Valley section of the West. In the House the only sections which registered a majority vote against the Henderson Bill were the South and the states of the North in immediate proximity to the Mississippi river.

The law is strong in its administrative features, and for this reason it has been saved from repeal. It provides

for a bankruptcy court in every county in the United States, and on this account the opposition to the former

Elements of strength in the law. laws because of the inconveniences and costs of attending the national courts has disappeared. The functions of the trustees and referees are clearly stated, and their fees are limited. The closing up of estates is put in the hands of creditors, and as the fees of officials cannot be collected until all the business affairs are settled the best inducement is offered to settle estates as early as possible.

One of the fundamental defects of the law was the definition of bankruptcy it introduced. Under this Act

Its weak features. a person is not considered insolvent when the aggregate of his property, exclusive of any

property which he "may have conveyed or concealed with intent to defraud, hinder, or delay his creditors," shall not at a fair valuation be sufficient in amount to pay all his debts. This definition of insolvency is different from any previous definition of the time. Ordinarily an insolvent is one who cannot pay his debts when they mature, or one whose liabilities exceed his assets. If solvency is proved by the alleged bankrupt at the time an action to make him a bankrupt is taken, in the great majority of instances the case must be dismissed, and the costs involved, including attorneys' fees of the defendant must be borne by those who bring the suit. In this we see clearly the handwriting of the debtor classes.

In order to put a man in bankruptcy petitioners must

give bond to indemnify the alleged bankrupt for costs incurred if they fail to prove their case. Under the law of 1867 the creditors took no risks. With this law the creditor takes all risks, the burden of proof is imposed upon him, and he bears the costs if his action has been hasty. In proving fraud everything seems to depend on the intent of the debtor, and the whole burden of proof is with the creditor. Even if fraud is proved the petitioner is liable for damages done the debtor if the property of the latter, aside from what has been fraudulently manipulated, is adequate to pay his debts. To protect the honest debtor the law shielded the dishonest, and it did not make fraud a crime. In some cases it was necessary for the creditor to prove that the debtor kept books before the latter could be compelled to produce them. The involuntary law, the one most desired by creditors in the interests of a sound credit system, was thus hedged about by so many limitations as to make it at times of doubtful value.

A good involuntary law is necessary to all bankruptcy legislation. Without it a debtor can determine when he will become a bankrupt, and in his liberty to do so there are many dangers. He could sell his property in bulk, transfer it as he pleased, permit liens on his estate to secure preferences, and then await a sufficient lapse of time before announcing his desire to have a bankrupt's privileges, to shield his fraudulent conduct from a bankruptcy court. With a good involuntary bankruptcy law the conduct of the debtor is checked, for if he is guilty of

Advan-
tages of a
good in-
voluntary
law.

fraud he does not know at what time action may be taken against him, and a bankruptcy court may be called on to pass judgment upon his methods. A well-balanced law ought to protect creditors from fraud as well as debtors from oppression,¹ and one of the defects of this original law consists in erecting barriers to prevent the prosecution of dishonest debtors.

Preferences are strictly prohibited by the law. Any judgment which is procured or permitted to be made in

**Prefer-
ences pre-
vented.** favor of any one while the debtor is insolvent, the effect of which will give one creditor a larger percentage of his debt than any other

person, is considered a preference; also, if a bankrupt gives a preference within four months before filing a petition or after filing the application and before the adjudication of the estate, the property or its value may be received by the trustee. The latter feature has made uncertain the work of the credit man. All liens secured or claims obtained against a debtor depend for their validity upon the probability of the debtor's going into bankruptcy within four months from the date of such preferences. Creditors have all along taken their chances. They have secured preferences in the same way as formerly, and have taken chances on having to surrender their claims. Even where creditors have secured preferences, they have often been debarred from taking action against debtors for further claims, since by doing so they would be compelled to surrender the advantages

¹ The law has been greatly improved in these respects by amendments.

already secured. A man who had a claim secured for \$50,000 would not be likely to take action to obtain the payment of a debt of \$25,000 if by doing so the debtor would be forced into bankruptcy, and the \$50,000 would have to be surrendered to be equally divided between all the creditors.

Under the law of 1867 the restrictions upon voluntary bankruptcy were very stringent and discharge was difficult. Under the law of 1898 discharge is comparatively easy. But two things prevent a discharge: (1) An offense which is punishable by imprisonment;¹ (2) failure to keep records or a destruction of records with intent to commit fraud. Neither a fraudulent preference nor the sale of goods in bulk will prevent a discharge. A failure to keep books or a destruction of records is inadequate to prevent a discharge unless in doing so fraudulent intent can be proven. If a debtor swears to his true condition, gives his property to his creditors, and turns his estate over to them, he must be discharged. Most laws both abroad and at home make the payment of a certain percentage of debts a condition necessary to a discharge. Not a cent needs to be turned over to creditors to permit a discharge if it can be shown that the debtor has no more property than the laws of the state permit a bankrupt to have.

A
discharge
from
bank-
ruptcy
easily
secured.

The law does not interfere with the exemption laws of the states. In this respect it does not provide for the uniformity which credit men desire. The laws of the

¹ See subsequent amendments.

states are very different on this point. Some exempt a certain minimum both of personal property and real

Law does not interfere with exemption laws of states. estate. Others leave the homestead with the bankrupt without regard to its value. In Texas the bankrupt is allowed \$5,000 for the lot upon which the homestead stands, and the homestead also whatever its value may be. In both Wisconsin and Kansas the homestead

is exempt. In these states if a man is about to become a bankrupt, a large part of his property may be put in a homestead and his creditors have no recourse. To give credit with safety, the credit man must have a knowledge of the homestead laws of the various states, and consequently different practices must be followed by credit men in giving credit.

With all its defects the friends of national bankruptcy legislation believed that it was superior to the insolvency legislation of the various states.

The amendments to the Act of 1898, approved February 5, 1903, were attempts to correct shortcomings which

Amendments of 1903. experience in putting the law into practice proved to exist. To the two causes preventing the discharge of a bankrupt four others were added: (1) Securing property upon a written false statement to secure credit; (2) transferring or concealing property four months prior to the filing of a petition in bankruptcy with intent to defraud creditors; (3) having been granted a discharge in voluntary bankruptcy within six years; (4) refusing to obey any of the orders of the court during bankruptcy proceedings.

Another amendment gives creditors power at a meeting for the purpose of examining a bankrupt to examine the wife of a bankrupt on matters concerning business transacted by her, to determine if she has "been a party to any business of the bankrupt." This amendment is of value in all cases where the husband keeps his property in his wife's name, pretending to act as her agent. Any other person may be called before the court to be examined with reference to his business relations with the bankrupt.

The fees received by trustees were changed by another amendment to the law. Aside from the fee allowed by the court when the petition in bankruptcy is filed, trustees may be allowed commissions on all disbursements made by them not "to exceed 6 per cent. on the first \$500 or less, 4 per cent. on all sums in excess of \$500 and less than \$1,500, 2 per cent. on moneys in excess of \$1,500 and less than \$10,000, and 1 per cent. on moneys in excess of \$10,000."

Many other amendments, not of a radical character yet essential in strengthening weak points in the law, were passed. The amendments of the Act of June, 1906, were all of a minor character.

In each of the last three years—1908, 1909, and 1910—bills have been before Congress to amend the National Bankruptcy Act for the purpose of making it more satisfactory to creditors. The bill introduced in 1908 by Congressman Sherley of Kentucky, was framed at a conference of representatives of the National Bar Association, the National Association of Credit Men, the National Board

Proposed
measure
of 1908.

of Trade, the Merchants' Association of New York, and the Commercial Law League of America. It was considered too radical a measure and was defeated. In 1909 a bill somewhat less radical, also introduced by Congressman Sherley, passed the House but was not reported out from the committee of the Senate to which it had been consigned, and was consequently defeated.

Some very important amendments were passed in 1910. One of the most important regulated the compensation

Amend-
ments of
1910
limited
compen-
sation of
officers of
court.

of receivers and trustees. It was claimed that too much of the assets of estates were absorbed by these officials, the courts holding that they had unlimited discretion in their allowances to these assets. Neither the law of 1898 nor the amendments of 1903 and 1906 attempted to limit the fees of receivers, and in practice they received more for their services

than trustees both when they were mere custodians of an estate for a week or two and when they had charge of an estate conducting the business for several months. The amendments reduced the compensation of all the officers to commissions, which varied with the amounts involved and were computed upon the actual cash realized by creditors. The maximum amount which could be paid officials was stipulated, the courts having power to allow less if they chose to do so.

Trustees were allowed a fee of five dollars when the petition was filed except when a fee is not required of a voluntary bankrupt.¹ Trustees, receivers, and marshals

¹ Section 48 of Act.

were to receive a commission on all moneys disbursed or turned over to any person "not to exceed 6 per cent. on the first \$500 or less, 4 per cent. on moneys in excess of \$500 and less than \$1,500, 2 per cent. on moneys in excess of \$1,500 and less than \$10,000, and 1 per cent. on moneys in excess of \$10,000."¹

In the case of the confirmation of a composition, the trustee, receiver or marshal may be allowed by the court commissions not to exceed 1/2 per cent. of the amount to be paid creditors. It is further stipulated that when the receiver or marshal acts as a mere custodian, and does not carry on the business of the bankrupt he shall not receive "more than 2 per cent. on the first \$1,000 or less, and 1/2 per cent. on all above \$1,000 on moneys disbursed by him or turned over by him to the trustee and on moneys subsequently realized from property turned over by him in kind to the trustee."² Before any allowance is made a notice must be given to the creditors specifying the amount requested.

Another section of the Act was amended so that receivers, marshals or trustees could be authorized to conduct business of bankrupts for limited periods. In such cases the maximum compensation which can be allowed them by courts is fixed at "6 per cent. on the first \$500 or less, 4 per cent. on moneys in excess of \$500 and less than \$1,500, 2 per cent. on moneys in excess of \$1,500 and less than \$10,000, and 1 per cent. on moneys in excess of

¹ Section 48 of Act.

² Section 48—d.

\$10,000.”¹ In case of the confirmation of a composition the commissions cannot exceed 1/2 per cent. of the amount paid creditors.

Another amendment increased the power of trustees, giving them control over “all property in the custody

Powers of trustees increased. or coming into the custody of the bankruptcy court,”² and vesting in them “all the rights, remedies, and powers of a creditor

holding a lien by legal, or equitable proceedings; and also, as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a judgment creditor holding an execution duly returned unsatisfied.”

The purpose of this amendment was to give the trustee the same right which any creditor would have if bankruptcy proceedings had not been instituted. A decision of the Supreme Court in the case of *York vs. Cassell*, held that the title of a trustee is simply that of a debtor, and that he has no more power than the bankrupt had. It held that if the bankrupt cannot set aside a transfer the trustee cannot do so because he has no more power than the bankrupt has. The effect of this decision was to prevent the creditors from setting aside a conveyance or preventing the evils of secret liens, because when the bankruptcy court took possession of the property the creditors were no longer free to act.

Another amendment makes it possible for the bankrupt to offer terms of composition to his creditors after

¹ Division E., Section 48.

² Section 47.

he has been examined in open court or at a meeting of the creditors, and after he has filed a schedule of his property and a list of his creditors. When a majority of his creditors representing a majority of the claims against him accept his terms, he may apply for the confirmation of a composition which the court is required to grant when it is convinced that such action is in the interest of creditors and that the bankrupt is not guilty of an offense which would prevent his discharge. Although it is possible for a debtor to make a composition with his creditors under the common law, under this bankruptcy statute a composition agreed to by a majority in number and amount of the creditors and approved by the court, is binding on all creditors, even including those who do not agree to it. Settlements by composition have the merit often of freeing from the stigma of bankruptcy one who is insolvent, of providing for a quick settlement, and of giving creditors in most instances larger shares than they would receive by regular bankruptcy proceedings.

The amendment of 1874 to the law of 1867 provided for compositions both before and after adjudication in bankruptcy. The English Bankruptcy Act of 1890 permits compositions of creditors with debtors under the supervision of the court, and these official settlements have become common in England. They have the merit (1) of making speedy settlements between debtors and creditors, (2) of preventing the creditor from being stigmatized as a bankrupt, and (3) of reducing court expenses for the administration of an estate.

By the law of 1898 any person who owed debts except a corporation could become a voluntary bankrupt. An

Corpora- amendment of 1910 gives all corporations
tions may except public and quasi-public corporations
become the privilege of voluntary bankruptcy. "Any
voluntary person, except a municipal, railroad, insurance,
bankrupts. or banking corporation, shall be entitled to
the benefits of this act as a voluntary bankrupt."¹
The extension of the voluntary provisions to corpora-
tions was seriously objected to by the opponents of the
law. Corporations are formed, they argued, so that
individuals may restrict their liability or be free from
liability altogether. Why should we enlarge the op-
portunity, they urged, for people to free themselves from
the payment of their just debts?

Another amendment is very explicit with reference to corporations that may be made involuntary bank-
Corpora- rupts. It states that "any moneyed, business
tions as in- or commercial corporation, except a municipi-
voluntary pal, railroad, insurance, or banking corpora-
bankrupts. tion owing debts of \$1,000 or over, may be
judged an involuntary bankrupt."² The same cor-
porations may be made involuntary bankrupts that
have the right of voluntary bankruptcy. Prior to this
only those corporations which were "engaged principally
in manufacturing, trading, printing, publishing, mining
or mercantile pursuits could be made involuntary bank-
rupts." In differentiating between these and other

¹ Division *a*, Section 4.

² Division *b*, Section 4.

corporations many anomalous distinctions were made by the courts in determining what are trading corporations, or corporations engaged in mercantile pursuits. Laundry companies, livery stables, mercantile agencies, hotels, and companies which construct bridges and piers, etc., have been by different courts included and excluded from the class of corporations which come within the province of the involuntary bankruptcy law. It was chiefly for the purpose of avoiding confusion resulting from diverse decisions of the courts that an attempt was made to substitute a logical for an arbitrary classification of corporations.

The law excluding wage earners and farmers from the provisions of involuntary bankruptcy remained unchanged.

The original law governing the discharge of bankrupts was strengthened by the amendments of 1903. A new amendment was added in 1910. A trustee is given the power of opposing the discharge of a bankrupt when he is authorized to do so at a meeting of creditors called for the purpose. The expenses incurred by the trustee are borne by the estate and are thus distributed among the creditors, whereas heretofore any creditor who opposed the discharge of a bankrupt was compelled to do so at his own expense.

In the section pertaining to the filing and dismissing of petitions it was provided in the former law that "a voluntary or involuntary petition shall not be dismissed by the petitioner or petitioners for want of prosecution or by consent of parties until after notice to the cred-

itors." But no provision was made to notify the creditors other than the petitioners, since the court had no means of knowing the names of the other creditors. The practice was common in many districts of dismissing involuntary petitions by request of the bankrupt, after the consent of the petitioners was secured. In some cases courts of bankruptcy have been used as a means of giving preferences by having proceedings dismissed after the petitioning creditors were paid in full. An amendment to the above clause prevents this abuse since the court must, "before entertaining an application for dismissal, require the bankrupt to file a list, under oath, of all his creditors, with their addresses," so that the intent of the law can be carried out by actually notifying all the creditors of the petition for a dismissal.

Another paragraph is added to the division on Preferred Creditors. It makes more definite the matter of preferences where the instrument of transfer must be recorded. If the registry of transfer is made within four months before the filing of the petition in bankruptcy, and the bankrupt is insolvent, and if the transfer operate as a preference and the person benefited by it has grounds to believe that the transfer is in effect a preference, it is within the power of the trustee to recover the property. In this case the amendment dispenses with the requirement of proof that the debtor *intended* to give a preference, a thing which is always difficult to prove.

The Bill introduced in 1908 was very carefully drawn

and became the model for the measures submitted in 1909 and 1910. Some concessions were made to those who opposed bankruptcy legislation, and consequently some provisions deemed very important were not included in the amendments of 1910. One of these sections modifies the definition of insolvency so that a person would become insolvent when the aggregate of his property, exclusive of that "which is exempt from being taken on execution under the laws of the United States or of the state or territory in which the proceedings in bankruptcy were begun," is inadequate at a fair valuation to pay his debts. The property excluded from valuation as a part of the assets of the debtor under the present law, is that which has been concealed, conveyed, etc., with intent to defraud. The necessity of inserting the additional clause was made obvious in the litigation of cases in states which have liberal exemption laws. The opposition to this clause was so strong that it was struck out of the Bill proposed in 1909, and it failed to pass as one of the amendments of the Act of 1910. The justice of the proposed change in determining insolvency cannot be called in question since the alleged bankrupt should have an adequate amount of property to pay his debts, which would be divided in case of bankruptcy among his creditors.

The proposed measure of 1908 more radical than the law which passed.

Another amendment proposed in the Act of 1908, but which failed to pass in 1910, made the failure to account satisfactorily "for a loss or deficiency of assets which

contribute to his bankruptcy" an objection to a discharge. This feature is new in bankruptcy legislation, having been introduced for the first time in the English Bankruptcy Act of 1890.

Many speeches were made in both branches of Congress favoring the repeal of the law. Motions to repeal the law were defeated in the House in 1909 by a vote of 182 to 111, and in 1910 by a vote of 166 to 90. These votes practically ended the efforts of the opponents of national bankruptcy legislation to consign the law of 1898 to the same fate as its predecessors met.

The arguments in opposition to the Bankruptcy Act, and especially to the amendments to it, made by the

minority of the judiciary committee may be summarized under the following heads: (1) The proposed amendments are in the interests of organized special classes; (2) the wide expanse of territory gives a large variety of industrial and commercial interests to which one uniform law is not adapted; (3) the costs of closing estates under a national Act are greater than under state laws; (4) the primary object of the bankruptcy law is to relieve unfortunate debtors from the weighty oppression of debts impossible for them to pay, and the proposed amendments are especially hard on the debtor classes.

The proposed amendments were urged by creditors in behalf of creditors, but it would not be difficult to prove that the changes contemplated would also benefit honest

debtors. Opposition to the law seemed to be aroused by interests independent of debtors and creditors that would profit by a repeal of the law.

There is no reason why one uniform bankruptcy law would not apply to all American conditions of bankruptcy just as many other laws on the statute books apply to a whole set of conditions of one kind or another. The strong argument for a National Bankruptcy Act is the weakness of the state insolvency laws, which are in operation in the absence of a national statute. Most states have no laws authorizing the involuntary seizure and distribution of the debtor's property. The southern states as a rule and many of the western states as has been shown, are hostile to this sort of legislation, and have consequently opposed the passage of involuntary laws by the United States Government. Trade and commerce are now national in their scope, and the best state insolvency laws are inefficient, owing to their limitations to state lines. Such laws have no power to bind property outside of a state or to relieve a debtor of his obligation to pay in full his creditors residing in another state; and in most large failures the debtor's property is not wholly in one state, nor do all his creditors reside in one state.

Advan-
tages of a
National
Bankrupt
Act.

It has not been and perhaps cannot be proved that the costs of closing estates under the National Act are greater than under state laws. Much may be said in favor of the contention that the purpose of the Act of 1898 was to relieve debtors. However, the fundamental

purpose of modern bankruptcy legislation is not to relieve debtors, but to divide the estates of bankrupt debtors equitably among creditors, with the least expense, and without injury to honest debtors.

CHAPTER XX

STATE INSOLVENCY LEGISLATION

THE inadequacy of state insolvency laws has all along been the strong argument for national bankruptcy legislation. The necessity for the regulation of trade between the states was the paramount argument for the adoption of the Constitution of the United States. The Union was about to split up into the various states because each had its own way of regulating commerce between itself and other states, and contentions arising from unjust discriminations frequently led to the verge of civil war. As a part of this movement to place the control of inter-state commerce in the hands of the national government, the constitution conferred on the general government the power of passing bankrupt laws.

Bank-
ruptcy and
the Con-
stitution.

The limitations on the powers of the states in their insolvency legislation proved to be an additional reason for the assumption of this power by the general government. In almost every large failure the debtor's property is not wholly within one state nor do all the creditors reside in one state. The insolvency laws of a state cannot enable a debtor to be discharged from the payment of debts owed in another state. Complete dis-

Why state
insolvency
laws are
inade-
quate.

charge is thus in many cases impossible of attainment under state laws. In most bankrupt laws and in the insolvency laws of many of the states, the desires of a certain percentage of the creditors in number and in amount, bind the rest with reference to terms on which estates are closed. But under the insolvency laws of a state no decision of the creditors of a debtor of that state can bind creditors residing in other states.

As a rule the state laws define an insolvent as one who is unable to pay his debts as they mature in the ordinary course of business. All that have **Definition of an insolvent.** insolvency laws of any kind provide for voluntary insolvency, and a number of the states provide also for involuntary insolvency.

Voluntary insolvency laws. As a rule in voluntary insolvency, debtors in failing circumstances may apply to the court having jurisdiction, offering to surrender their property to be divided among their creditors. At the time of presenting their petition or subsequently, they are required to give the names of their creditors, their places of abode, the amounts owing each, etc. Usually this statement is made under oath. The assignment of the debtor's property does not affect that which under the laws of the state is left with insolvents. In some states, California, Wisconsin, Nevada and Massachusetts,¹ the debtor must owe a certain sum of money before he can apply for the benefits of the law.

¹ The amount required in California and Wisconsin is \$300; in Nevada \$500; in Massachusetts \$250, and in Idaho \$300.

Maine, Vermont, Massachusetts, Rhode Island, Connecticut, Maryland, Minnesota, Louisiana, Nevada, and California have involuntary as well as voluntary insolvency laws. The petition to make a debtor a bankrupt must be filed by creditors with the judge of the local court, charging him with an attempt to evade the payment of his just debts. The debtor's fleeing from the state where he resides, removing his property, or concealing his property with the apparent intention of defrauding his creditors, preferring creditors, allowing judgment to be executed in favor of creditors, or taking action in contemplation of insolvency, are the usual conditions which give creditors the right to force a debtor into insolvency. Some officer of the court takes charge of the debtor's property, a meeting of the creditors is called, at which the debtor may attend, and the petitioning creditors are required to establish one or more of the above charges before the court can act favorably on their petition. With a few minor differences the laws of the various states with reference to involuntary insolvency are similar. Some states require the petition of a certain number of the creditors, and others require the owing of a minimum debt, as requisite to involuntary proceedings.

After the petition is granted the methods of procedure in both voluntary and involuntary bankruptcy are practically the same. The debtor must furnish to the court under oath a list of his creditors, their residence, the amounts owing each, and his total assets.

Involun-
tary
insolvency
laws.

Method of
procedure
in both
voluntary
and in-
voluntary
bank-
ruptcy.

At a meeting of the creditors called by the court, they are required to prove their claims against the debtor's estate, and those proving their claims elect an assignee or assignees to take charge of the debtor's property.

In most of the states a double majority is required, that is, a majority of creditors who hold claims representing over one-half of the amounts owed by the debtor. The assignee possesses the same privilege with reference to the debtor's property as the latter would enjoy in the absence of insolvency proceedings. He collects all debts owed the debtor's estate, and under the supervision of the court, distributes the debtor's property equally among the creditors. In most states he is required to give bond for the faithful discharge of his duties. Some states prescribe conditions under which he may be removed. Some states prescribe that he be allowed a reasonable compensation or compensation on a percentage but even under the common law, he is to be allowed reasonable pay for his services. In several states the debtor selects his own assignee. When making an assignment in Indiana¹ and Ohio² the debtor may select his own trustee, unless creditors representing over one-half of his debts object, in which case the Circuit Judge chooses the trustee. In Wyoming³ the assignee selected by the failing debtor must give adequate notice of his appointment in newspapers and must have the property which comes in his possession appraised by two trustees.

¹ Brown's Annotated Statutes Review, 1208.

² Bates' Annotated Ohio Statutes, Vol. 2, Section 3141-3167.

³ Wyoming Compiled Statutes, 1910.

In some western states, notably Utah and Oklahoma, a voluntary assignment for the benefit of creditors is void under the following conditions: (1) if a preference is granted on a contingency; (2) if it tends to coerce a creditor to release or compromise his demand; (3) if it provides for the payment of a claim known to be false; (4) if it reserves any interest to the debtor not allowed by state laws before the debts are paid; (5) if it confers power on an assignee to delay the disposition of the property.

Voluntary
in-
solvency
in Utah
and Okla-
homa.

An existing attachment is not made void by proceedings in insolvency unless there is a specific law prohibiting such attachments. On this account in the states¹ where no such laws exist, creditors are vigilant in securing preferred claims by getting attachments on the debtor's property. However, the laws of many of the states make attachments void when obtained within a prescribed time previous to insolvency. Even in such cases, vigilant creditors secure preferred claims, taking chances that the time of these claims will not fall within the prescribed limit.

Many states make the conveyance of property immediately preceding insolvency proceedings to keep it from falling into the hands of creditors fraudulent, and such property may be reclaimed by the assignee. In these states false claims paid out immediately preceding insolvency proceedings may also be recovered by the assignee.

When an estate is closed all the creditors share equally

¹ Dunsecomb: *Bankruptcy*, p. 163.

in proportion to their claims after the preferred debts are paid. These in order of priority of claim are (1) debts due the United States; (2) debts and taxes owed the state; (3) in some cases the claims of a landlord for rent; (4) in many states, wages for labor performed within a limited period preceding insolvency; (5) preferred creditors.

The conditions of discharge vary in different states. As a rule the debtor must surrender his property for the benefit of his creditors, giving a correct inventory of it, the names of his creditors, their residences, and the amounts owed each. In some cases he is required to state the causes of his indebtedness. In some states he may file a petition for his discharge when he surrenders his property; in other states he must postpone his application several months. After his property is divided among his creditors, if he has not been guilty of fraud, he may be discharged by the court from the payment of the residue of his debts. Fraudulent conduct, which prevents a discharge, often means, as in Wisconsin,¹ (1) swearing falsely regarding his estate and debts, (2) selling or transferring property after petitioning to be adjudged a bankrupt, (3) secreting his estate or books, and (4) preferring creditors or permitting an unfair claim to prevail against the estate.

In some states, especially in New England, the desires of the creditors are considered in granting a discharge.²

¹ Wisconsin Statutes, 4282-4206.

² Revised Laws, 1902, Vol. II, pp. 1433-1468.

In Massachusetts, if the assets do not pay 50 per cent. of the debts, a debtor cannot be discharged without the consent of a majority in number and in value of the creditors. If the debtor becomes a bankrupt a second time, then the consent of three-fourths in number and amount of the creditors is necessary to a discharge. The debtor is prevented from receiving a discharge if he has failed to keep proper books; however, in this case if he is not guilty of fraud, the court may discharge him after six months, if his debts do not exceed \$5,000 and if two-thirds in number and amount of his creditors consent to his discharge.

Bank-
ruptcy in
New
England.

In Maine¹ a debtor may be discharged if he is not guilty of fraud. A second discharge requires the consent of a majority in number and value of his creditors, and a third requires the consent of three-fourths in number and value of the creditors. When a debtor is a voluntary bankrupt the consent in writing of a majority in number and amount of his creditors is necessary to a second and a third discharge.

Discharge
from debts
in Maine.

When a debtor applies for a discharge in New York,² he must send with his application the petition of his creditors to whom he owes at least two-thirds of his debts.

The insolvency law of Rhode Island³ makes a distinction between traders and other classes. If the insolvent

¹ Revised Statutes, 1903, pp. 628-648.

² Consolidation Laws, VI, pp. 860-928.

³ Rhode Island, General Laws, 1909, pp. 1221-1239.

**In-
solvency
law in
Rhode
Island.** petitioning for a discharge is a merchant, manufacturer or trader, "he shall not be discharged if he has, within four months prior to being adjudged insolvent, failed to keep or has destroyed his books of account, or papers, from which his true condition may be known, with intent to hinder, defraud or delay his creditors; if he has given a preference, or made a false statement in writing to secure credit, or if he has suffered a lien to be secured on his property."

Texas.¹ Texas¹ has a peculiar assignment law. A debtor may make an assignment for the benefit of as many creditors

**Insolvent
law in
Texas.** as will accept the terms of payment made possible by the distribution of his property.

The insolvent is then discharged from the payment of further sums to these, providing that the debtor's assets will pay one-third of the claims of these. The insolvent is not discharged, however, from the payment of all claims in full of those who do not accept the terms of settlement and who consequently receive nothing from the distribution of the assets of the debtor.

**Imprison-
ment for
insol-
vency.** Insolvent laws in the earlier sense, that is, that action the purpose of which was to secure a discharge from

prison, must be initiated by debtors are uniform in Arkansas, Illinois, Kentucky, Montana, New Jersey, New York, North Carolina, Ohio, Pennsylvania, and Wisconsin. As a rule in these states, when a debtor is arrested and placed

¹ Civil Statutes, Sayles 21, pp. 61-73.

in jail, he applies to the court for a discharge from jail, appending to his petition an inventory of his property, giving its amount and value, stating the names and residence of his creditors, and declaring that he is willing to surrender his property for the benefit of his creditors. The court calls a meeting of the creditors to enable them to give reasons why the debtor should not be discharged. If it is established that the debtor has not committed a punishable offense under the law, he is discharged from prison. In most cases the debtor is given the privilege of a trial by a jury if he desires it. When convicted of certain classes of frauds, in several states debtors may be sent to prison.

The most complete bankruptcy laws are found in New England. All of the New England States have both voluntary and involuntary bankruptcy laws. The creditors elect their assignee and the desires of the creditors as a rule, are considered in discharging an insolvent from his debts. The law states in great detail what the insolvent is required to do both in voluntary and in involuntary insolvency. The Acts preventing a discharge are very clearly set forth. Several months preceding the Acts of insolvency the debtor cannot grant preferences, and attachments made within that period may be dissolved.

Insol-
vent laws
in New
England
very
complete.

In her insolvency laws Georgia makes the same distinction between traders and non-traders as was formerly observed in England, and is still observed on the continent. Traders only may be made involuntary bankrupts

whereas all other classes have the privilege of voluntary bankrupts. Any person is defined as a trader¹ "who is engaged in buying and selling real estate or personal property, or who is a banker, broker, commission merchant or manufacturer of articles which exceed in value \$5,000 a year."

Insolvent laws in Georgia. When a debtor fails to pay his debts as they mature, creditors representing one-third of the unsecured debts may petition the court of equity to collect the debts. The chancellor has the right to grant injunctions and to appoint receivers. After the appointment of receivers no creditor can acquire a preference or secure a lien or judgment against the property of the debtor. After the debtor has surrendered all his property for the benefit of his creditors, the chancellor may recommend that the creditors release him from further liability to pay the balance of his debts; but the power to do so is wholly in their hands.

Corporations, other than municipal, have the privilege of making an assignment, but in doing so they are not permitted to prefer creditors.² Persons and firms in making an assignment may prefer creditors, giving mortgages, liens, etc. Assignments must convey all property and lists of creditors with their addresses and the amounts owed each must be furnished. Within fifteen days the assignor and assignee must prepare lists of property with its valuation, which must be kept on file in the County Clerk's office for ten days. Al-

¹ Code of State of Georgia, Vol. I, 1911.

² Code of State of Georgia, Vol. I, 1911.

creditors must be notified, and they have the privilege of inspecting these lists.

Louisiana has both a voluntary and an involuntary insolvency law.¹ Her insolvency law resembles the bank-

**Insolvent
law in
Louisiana.** ruptcy system of the continent and on that account it has from the American point of view some peculiar features. Upon failure

to pay his debts a judgment creditor may compel his debtor to produce his property by petitioning the court to have the property surrendered. The court then requires the debtor to file a list of his property, the names of his creditors, their residences, and the amounts owing them. The judge then calls a meeting of the creditors at which a majority in number and amount determine if the debtor's property is to be surrendered. If the property is to be surrendered the creditors elect syndics who take control of the property. Upon refusal to surrender his property, a debtor may be sent to jail.

A fraudulent debtor is defined as one who has neglected to declare any of his property, "who has changed or concealed his books," who has given a preference within a year of the acts of insolvency or who committed any other act to defraud his creditors. When the debtor is convicted of fraud by a jury he is to be sentenced to imprisonment for three years, and is to be deprived in the future of the privileges of the insolvency law. If the debtor is guilty simply of granting an unjust preference he may be relieved from imprisonment by restoring to

¹ Constitution and Revised Laws of Louisiana, 1904, Vol. I, pp. 810-825, Solomon Wolff.

his creditors the amount unlawfully conveyed. If the preference was given within three months of his failure, the preferred creditor loses his advantage and the debtor is to be denied the privileges of the insolvency law.

CHAPTER XXI

LAWS REGULATING THE SALE OF GOODS IN BULK

PREVIOUS to 1900 but three states Louisiana, Oregon, and Minnesota, had laws regulating the sale of goods in bulk. In January, 1910,¹ thirty-nine states movement and the District of Columbia had laws for bulk governing the sale of goods in bulk. The sales laws. rapidity of the movement in the direction of legislation of this class amounting to almost a crusade, was primarily the result of action taken by the National Association of Credit Men in 1897. Believing that rigid legislation regulating sales of this class would place credit on a higher plane, this organization through its legislative committee carried on a persistent campaign in every state in the Union.

A model law was framed by the National Association and then each state in turn was asked to pass the law or one including its most important provisions. The uniformity in the bulk sales laws of the different states is the best evidence of the singleness of purpose back of this legislative movement. One judge in writing the majority opinion declaring a law unconstitutional

Bulk sales laws passed as result of a systematic campaign.

¹ The states not having bulk sales laws at this time were Illinois, Iowa, Missouri, Arkansas, Alabama, Kansas, South Dakota and Wyoming.

comments on this fact.¹ "Statutes that are passed pro bono publico rarely sweep the country with such irresistible momentum, while much fantastic legislation has resulted from organized crusades upon legislatures by the advocates and supporters of special classes. This statute is evidently of that kind, which has been so frequent of late, a kind which is meant to protect some class in the community against the fair, free and full competition of some other class, the members of the former class thinking it impossible to hold their own against such competition, and, therefore, flying to the legislature to secure some enactment which will operate favorably to them or unfavorably to their competitors." Whatever may be said of the motives ascribed by this judge to those responsible for this and other legislative campaigns, the results achieved were accomplished by careful planning and by persistent efforts.

In the absence of legislation of this sort practices are resorted to which are injurious to trade. Credit is granted because of the necessity of paying debts from the proceeds of goods purchased. It is granted under the assumption that the customary methods of trade will be followed by the retailer and that the latter will pay his debts when his goods are sold. When goods are sold in bulk, the customary methods of the merchant are abandoned. The seller does not need to make provision to liquidate the

¹ Judge Werner in declaring the New York law of 1902 unconstitutional.

liabilities, and the creditor has no claim whatever against the stock after it is sold.

In selling goods on time the jobber or manufacturer considers the credit standing of the purchaser, his business ability in his particular trade, his chance for success, his honesty, integrity, etc., which are all a matter of record. He assumes as a matter of course that the business in which the customer is engaged will be carried on in the customary way. If the seller believed that the regular retail methods would be abandoned and that the entire stock would be sold at one time to a single purchaser, ordinarily the goods would not be shipped, and commercial credit would not be granted. It is for these reasons that bulk sales laws make different requirements of those who sell goods in bulk from those who follow the same methods of trade that are assumed when credit is granted, and the advocates of stringent legislation insist that no harm or inconveniences will come to honest merchants by these distinctions.

The chief abuse arising from the sale of goods in bulk takes as a rule this form. A merchant who has purchased a stock of goods chiefly on credit, sells his entire stock to a single purchaser. He realizes at once on the sale and his creditors are helpless in the absence of legislation to cover this specific case. The purchaser may be aware often of the motives of the seller, but if the purchase is made at an unreasonably low figure he has no financial interest in exposing the purposes of the seller.

The chief
abuse
which the
bulk sales
law
corrects.

Another irregularity aimed at by the bulk sales law is the transformation of a business from the single entrepreneur or partnership organization into the corporation. The purchasing corporation practically buys up the entire stock, good will, etc., and perhaps the buildings and equipment, although the original owner may become a stockholder in the corporation to the extent of his original possessions in the business, and without a law governing such sales, the creditors of the seller have no more title to his property than if it had been disposed of outright.

To correct these abuses the National Association of Credit Men has proposed a specific law, the chief provisions of which have been incorporated in nearly all the laws of the states which have restricted sales in bulk. The important law.

provisions of this law are the following:

- (1) Five days before the sale, the seller and purchaser must make a detailed inventory showing the quantity and as far as possible the cost price of each article to be sold;
- (2) five days before the sale the purchaser must make an inquiry as to names, places of residence or of business of all creditors of the seller and the amount owing each creditor. A written answer to these inquiries must be secured from the seller and retained six months after the time of sale;
- (3) the purchaser, five days before the sale, must notify all creditors of the proposed sale, the cost price of the goods to be sold and the price to be paid for them;
- (4) five days before the sale the seller must answer all questions in writing truthfully, and a failure to do so or a failure to make complete and true answers will be

treated as a misdemeanor and be dealt with accordingly. A failure to carry out the above provisions makes the sale fraudulent and void as against the creditors.

Bulk sales are made frequently as low as 40 or 50 per cent. of the real value of goods, and in such cases the sale is usually made with intent to defraud, and the purchaser is in collusion with the seller. In compelling an inventory to be made giving the cost price of the goods to be sold and the proposed selling price, the real purpose and nature of the transaction is made obvious. The purchaser is required to give these facts to the creditors of the seller several days before the sale takes place, and if the latter is attempting to sacrifice the goods with fraudulent intent, his efforts may be thwarted by those concerned. The time limit required of purchasers to notify creditors prior to the sale varies in the different state laws, but in no instance is it less than five or more than ten days.

Inventory
of goods
to be sold
and noti-
fication of
creditors.

Most of the laws contain a clause stating that the Act shall not apply to sales by executors, administrators, receivers, assignees or trustees in bankruptcy for the benefit of creditors or to public officers conducting sales in their official capacity.

The form of the laws vary with the time of their enactment. Louisiana has the most drastic law on sellers and purchasers of goods in bulk, but this law was passed (1896) before the crusade against bulk sales was begun by the National Association of Credit Men. This law makes it a misde-

Louisiana
bulk sales
law.

meanor to purchase goods under a fictitious name with intent to cheat or to defraud, and a penalty of a fine or an imprisonment from six to twelve months is provided. Buying on credit and selling out in the usual course of trade with intent to cheat the seller is also treated as a misdemeanor for which the above penalty is provided. One who purchases goods in bulk which were not paid for by the seller, without securing a written sworn statement from the seller that the goods had been paid for, is considered guilty of a misdemeanor for which the usual penalty for that offense in Louisiana, is imposed. Fraudulent intent is established in this Act by the failure of the vender of goods in bulk to pay the sellers for their goods; and by the failure of the purchaser to secure from the seller a signed or sworn statement.

The Oregon law which was passed in 1899 required the purchaser of goods in bulk to obtain a written state-

The Oregon law. ment from the seller containing names and addresses of creditors and the amounts owed each, and these facts were to be communicated

to the creditors personally or by registered letter several days before the consummation of the sale. Failure to comply with the provisions of the Act makes the sale fraudulent, and a right of action is given to creditors of the seller against the purchaser of goods in bulk. The making of a false statement by the seller is considered perjury or a misdemeanor, and the offender is subjected to the penalties imposed by the laws of the state for such offenses. The Minnesota law, passed also in 1899, contains all these provisions except the last one.

With unimportant exceptions all the laws contain these provisions, the important difference being with reference to the making of a false statement by the seller a criminal offense. Of the states which were first to pass bulk sales laws, seventeen made the giving of a false statement by the seller, with reference to his goods which were sold in bulk, either a misdemeanor or perjury. The laws of seventeen other states do not make the giving of a false statement a criminal offense, but simply make the sale of goods in bulk void and fraudulent. The first law passed by Ohio in 1902, which was declared unconstitutional, made the giving of a false statement by the seller a misdemeanor, but the second law passed by Ohio in 1908, also declared unconstitutional, contained no provisions whatever with reference to a false statement.

In most of the laws governing bulk sales the seller is required to furnish to his purchaser an inventory of the stock to be sold, giving the cost price of each item so far as he can, and in some instances the selling price of the entire stock. He is also required to furnish him a list of his creditors, their residence, and the amounts owed each. What most bulk sales laws require.

As a rule, this data, together with a notice of the time of sale, is to be furnished by the seller to the creditors from five to ten days preceding the time of sale. In the states where it is required that this inventory is to be preserved, it must be retained six months. In but few instances do the laws require a public record of the inventory. The California law of 1903 requires

the seller of goods in bulk to file in the office of the county recorder, at least five days before the sale, a notice of the sale, the name of the purchaser, and a statement of the character of the property to be sold and the purchase price. Under this law the purchaser is freed from any responsibility in making the transaction.

The Connecticut law of 1903 requires the seller to record in the office of the town clerk, in the town where the recorder conducts his business, a notice of his intention to sell the property in bulk, a description of it, and the name of the purchaser.

The purchaser is free from any obligation with reference to the creditors of the seller except that the sale is void if the above requirement is not carried out.

The South Carolina law (1906) requires the seller of goods in bulk, who intends to retire from the retail business, to make a complete inventory of all the property he proposes to sell with a statement of the ruling wholesale price of each item.

The inventory must also include a complete list of his creditors with the amounts owed each and his statement under oath that the facts reported are true. The inventory must be furnished the purchaser, and copies must be retained in his own possession six months. Ten days before the termination of the sale, the seller and purchaser must give notice to all creditors of the seller of the intended sale and purchase. The inventory of the property must be retained by both seller and purchaser six months, and be subject to inspection by any of the creditors. A failure

to carry out any of these requirements makes the sale fraudulent, and gives the creditors of the seller a title to property in the hands of the purchaser, and the latter is made liable for the value of any property he sells.

Three Acts passed in 1907 introduced new features governing the responsibility of purchasers and sellers. The Nebraska law requires the customary inventory to be made by seller and purchaser, and the notice by the purchaser to the creditors of the seller of the intended purchase of the property. The inventory and the notice may be omitted if the seller files with the county clerk where the stock is situated an agreement with his creditors waiving the requirement of the inventory and notice.

New
features
in bulk
sales law.

The North Carolina law makes a bulk sale void unless the seller makes an inventory of the property with the cost price of each item which he proposes to sell and notifies all his creditors of the proposed sale. However, the inventory and the notice may be waived if the seller executes a bond to a trustee covering the value of the goods conditioned upon the use of the proceeds of the sale to pay creditors the amounts due them after making adequate allowance for the value of the personal property allowed by law.

The Nevada law makes the usual requirement of inventory, notice to creditors of the seller, and considers a false statement by the seller perjury, for which offense a heavy penalty is given. All the provisions of this Act, however, may be waived if the seller secures the consent of a majority in number and amounts of his creditors.

In four states, New York, Utah, Ohio and Illinois, laws have been declared unconstitutional, but in the first two of these new laws have been passed. **Laws declared unconstitutional.** The New York Act of April 11, 1902, was declared unconstitutional but a new Act approved May 3, 1904, is in force. In Utah the law of March 14, 1901, was declared unconstitutional, but the law of March 9, 1905, is still in force. The Ohio Act of April 4, 1902, was declared unconstitutional by the Supreme Court of the state June 7, 1904, and a new law passed April 30, 1908, has also been declared unconstitutional. The Illinois law passed May 13, 1905, was declared unconstitutional June 18, 1908.

In all other states the bulk sales laws are in force. In seven of these, Washington, Tennessee, Massachusetts, Connecticut, Michigan, Kentucky, and Oklahoma, the laws were declared constitutional by the Supreme Courts of the states after the issues were squarely drawn on constitutionality by lower courts.

The objections to the laws on constitutional grounds were based chiefly upon the infringement of the common law, being in restraint of trade, of restricting the right of contract, of imposing hardships on certain classes of people, and of infringing on the property rights of classes of producers.

The first Ohio law. The first Ohio law which was declared unconstitutional was more drastic than most laws of this class. In contrasting the Ohio law with others to which the attention of the court had been directed that had been declared to be constitutional,

the comment was made that they "present substantial differences from those which are involved in the present inquiry." The sale of an entire stock of merchandise outside of the regular course of trade is considered fraudulent against the creditors of the seller unless the following regulations are carried out: (1) The seller must deliver to the purchaser (a) a complete list of all his creditors with their addresses, (b) the amounts owed each, and (c) the books or original invoices "from which the cost price of the merchandise can be ascertained"; (2) the seller and purchaser are required six days before the sale to make an inventory showing the cost price to the seller of each item included in the sale; (3) the list of creditors, books, invoices and inventory must be retained by the seller six months after the sale, subject to the inspection of the creditors of the seller; (4) the purchaser is required to notify in person or by registered letter all the creditors of the seller at least five days prior to the sale of the goods to be sold, their cost price and their selling price.

If the seller fails to comply with the requirements of the law or if his report to the purchaser is incorrect, and in consequence of this any creditor is wronged or defrauded, the seller's offense is considered a misdemeanor which is subject to a fine or imprisonment or both.

The decision of the Supreme Court was given in the case of *Miller vs. Crawford*, June 7, 1904.¹ The court stated as a fundamental proposition from the Bill of Rights that "the terms of the instrument compel the

¹ 70 Oh. St. 207.

**Decision
of
Supreme
Court on
first Ohio
law.**

conclusion often stated that the holding of private property, its acquisition and its use are subservient only to the welfare of the public." The following propositions determined the decision of the court:

1. "For every restriction upon the enjoyment and use of property there must be substantial reasons of a public character; 2. if a restriction is placed upon the alienation of property, it must be for the entire body of the people or, at least, of all who are within the reason of its restriction; 3. a distinction sometimes thought important between property in lands and in chattels upon the ground that the former is derived from the state, will at least justify the conclusion that legislative control over chattels is not greater than over lands; 4. the express limitations which the constitution imposes upon the legislature apply to the exercise of powers which are truly legislative in character, and since none but legislative power is committed to it, the exercise of that power is also confined within all the limitations which are suggested by its nature."

The court then goes on to analyze the Act to show that its provisions are in conflict with these principles. It is asserted that a sale of goods in bulk is absolutely void unless all of the various provisions of the Act are complied with. The requirements of the seller cannot be carried out when he does not know who all his creditors are and the amounts he owes each. The Act took effect as soon as it was passed, and it applied to stocks of merchandise however long they were in the possession

of the merchant. The requirement that the seller should transfer to the purchaser books or original invoices to show the cost price of goods was declared impossible of accomplishment when the seller did not have adequate data. The decision states, moreover, that the purchaser cannot in the nature of things have the knowledge necessary for a compliance with the law.

The court goes on to say "Applying the familiar and unquestioned rule that the validity of an Act is to be determined by its practical operation and not by its title or declared purpose; this Act, under the guise of preventing fraud in such sales, prohibits them altogether, and thus places on the enjoyment of property an important restriction which no public interest requires and which the constitution therefore forbids. One who challenges the soundness of this conclusion should be prepared to maintain the validity of an Act expressly forbidding sales of stocks of merchandise in bulk. By the Act the Legislature has attempted to discriminate unwarrantably among debtors and creditors. It does, in liens, apply to sales in bulk by wholesale as well as by retail dealers in merchandise. But conceding, for present purposes, that when reasons for legislative discrimination exist, then sufficiency is to be determined finally by the legislature; no reason is suggested by council, nor does any occur to us, for a legal discrimination in the relation of debtor and creditor between those who come into that relation with respect to the purchase and sale of merchandise and those between whom it exists with respect to chattels in general. Although the Act applies to all the creditors

of the seller, it applies to those only who are creditors of the owner of a stock of merchandise, and thus an unreasonable burden is imposed upon a limited class of debtors for the supposed benefit of a limited class who are creditors."

With reference to decisions affirming the constitutionality of corresponding laws in other states, the court asserts that if the reasoning in those cases were accepted as sound, "the cases would be plainly distinguishable by essential differences in the provisions of the statutes, and, in one instance at least, by a difference in the constitutional provisions involved."

A law passed April 30, 1908, was drawn in such a manner as to free it from the provisions which made

The second Ohio law. the previous law unconstitutional. This law has also been declared unconstitutional.

While the former law contained more rigid provisions than most of the laws of other states, the provisions of this law are mild as compared with those of some states regarding fraudulent conveyances. A sale of goods in bulk made with fraudulent intent is void against the creditors of a seller, and when creditors bring suit a receiver may be appointed to take possession of the assets of the debtor. Unless the seller at least seven days previous to the transfer, records in the office of the county recorder where the business is conducted a notice of his intention to sell the goods with their description and the conditions of the transfer, it will be presumed that the goods were sold with fraudulent intent. The above requirement may be dispensed with

when the sale is made "by order of a court or by an executor, administrator, guardian, or assignee."

The case at issue was one in which a merchant sold his goods without having not less than seven days previous to the sale published with the recorder of the county as the law required, his intention to sell his goods in bulk. The creditors of the seller brought suit against the purchaser of the goods claiming that they were sold with fraudulent intent.¹ Both the Common Pleas and the Circuit Courts decided in favor of the defendant, and upon appeal, the Supreme Court upheld the decision of the lower court in 1911. In its decision the Supreme Court followed the same line of argument it pursued in holding the former bulk sales law unconstitutional. The Court held that this law imposed upon a certain class of people in selling goods obligations and burdens not imposed on others, as fraudulent intent is presumed if those who sell goods in bulk do not file with the county recorder at least seven days prior to their sale their intention to do so, and they are required to prove that the sale was not made with fraudulent intent when they do not comply with the above named requirement of the law. All other venders of goods or those who sell in any other way than in bulk are not required to give public notice of their intention to sell, and in no other case is fraudulent conduct assumed before the person is proven guilty. Commenting on this the Court says "Counsel have not communicated to us any view upon which we

The
Supreme
Court's
decision
on second
law.

¹ Ohio State Reports, V. 84, pp. 328-345.

could sustain the proposition that laws can be equal which accord to one, without proof, rights upon which they accord to others only upon proof." The decision is then concluded with the following significant statement: "It seems to us that this act very plainly from its nature, takes its place among the enactments which constitute the promoted legislation of the state not suggested by comprehensive views of the rights and interests of all the people, but furthered by those who desire to obtain advantages not accorded by the general law."

The Bulk Sales law of Tennessee which contains the same provisions as the corresponding laws of a majority

Supreme Court decision in Tennessee. of the states was declared constitutional by the Supreme Court. The Act required an inventory of goods to be sold, a correct report from seller to purchaser of the cost price of the goods, the names and addresses of the creditors of the former, while the purchaser was to notify the seller's creditors of the intended purchase several days in advance. In the case¹ which came up, the issue on constitutionality was definitely drawn.

An attempt was made to set aside the Act as class legislation because it applied to those dealing in merchandise and not to such other persons as farmers, manufacturers, etc. In reply to this the court held that "the statute is a mere regulation of the mercantile business, designed to secure to creditors of merchants a just participation in the distribution of the assets of such merchants, and to prevent fraudulent preferences and

¹ Jno. F. Neas *vs.* Borchus & Co.

practices by them, and is a valid exercise of the police power of the state." The court held that the act was valid for the following reasons: 1. "It was intended to prevent the practice of fraudulently selling out goods to the injury of creditors by merchants; 2. it was merely a regulation of the business of merchandising; 3. it is not class legislation, and that the limitation of the Act to merchants is not an arbitrary classification, that it does not take away the property of the citizen, but only regulates the sale of merchandise in such manner as to prevent frauds."

The Michigan law which contains the usual provisions ¹ of bulk sales laws was declared constitutional by the Supreme Court Sept. 20, 1906. It was contended that the Act was class legislative for two reasons: "First, because it limits its operation to merchants, and does not include farmers, manufacturers, etc.; second, that it does not relate to merchants who owe no debts." The court held that "a sufficient reason for not including in its provisions merchants who owe no debts is found in the apparent purpose of the Act, which is to protect creditors. If there be no creditors, there is no one requiring protection." With reference to the other contention, the court held that "it is easy to discover reasons for apprehending and guarding against fraudulent disposition of stocks of merchandise by debtor owners which would not relate to other species of property." After quoting from another decision, the court asserted that

Supreme
Court
decision
in
Michigan.

¹ See case of Howard W. Spurr, et al. *vs.* Dayton A. Travis, et al.

this is not class legislation. "It is well known that the business of retailing goods, wares, and merchandise is conducted largely upon credit and furnishes an opportunity for the commission of frauds upon creditors not usual in other classes of business."

The Supreme Court of Washington sustained the constitutionality of the Bulk Law¹ of that state even though the law was more drastic in one particular than bulk laws of most other states.

Supreme Court decision in Washington. Aside from the usual provisions of such laws,

the Washington law definitely stipulates that the making of a false statement knowingly or wilfully "by the seller to the purchaser with reference to his creditors, the amounts owed them, etc., is considered perjury, and upon conviction the seller may be either imprisoned or fined."

The Act was objected to on constitutional grounds for the following reasons: (1) It deprives persons of their property without due process of law; (2) it is in restraint of trade. It was contended that the constitution was violated on the first ground because the Act restricted the right of an owner to dispose of his property. The court replied that "the Act does prohibit owners of certain kinds of property from disposing of it in a particular way, without complying with certain conditions, but it is not for that reason necessarily unconstitutional. Statutes familiar to every person, such as those regulating the mortgaging and sale of personal property, requiring certain articles of food made in imitation of other well-

¹ John H. McDaniels vs. J. J. Connelly Shoe Co.

known articles to be branded with their true names, regulating the sales of poisons, and the like, are statutes restricting the rights of an owner in relation to his property, yet such statutes, in so far as they tend reasonably to prevent injury to the public, and frauds among individuals, are uniformly held constitutional."

With reference to class legislation the court contends that "it is well known that the business of retailing goods, wares and merchandise is conducted largely upon credit, and furnishes an opportunity for the commission of frauds upon creditors not usual in other classes of business. In fact, charges of fraud made against retail dealers who have sold their stocks in bulk are among the most common with which the courts are called upon to deal. Legislation therefore which restricts the absolute right of persons engaged in such business to transfer their property, so long as it applies to all persons engaged therein, is not class legislation within the meaning of the constitution, merely because it does not apply to all owners of property."

The court also concludes that the Act is not in restraint of trade; that it does not prevent the sale of goods in bulk; and although it will restrict the sale of goods in this manner it is only one of the cases "where private desire must yield to the public good."

The contention that bulk sales laws interfere with the freedom of contract and are in restraint of trade is best answered by Justice Vann of the Court of Appeals of New York in giving the dissenting opinion of the court which stated the bulk sales law of that state unconstitu-

tional. With reference to this the former law, the decision says, "When a merchant owes more than he can pay he has no substantial equity in his stock of goods, and the claims of his creditors are superior to his own. He may be imprisoned on civil process and punished criminally for making a fraudulent disposition of his property, and any person who is a party or privy to the fraud may be punished in the same way. Interference with his liberty and property by such methods has never been successfully questioned as a violation of fundamental rights. Many restraints upon the freedom of contract, some of which reach back to colonial history, have passed without challenge, or, if challenged, have uniformly been sustained as valid. The Statute of Frauds, the act to prevent fraudulent conveyances, insolvent laws, the Recording Act, the prohibition of usury, lien laws, regulations in relation to chattel mortgages, conditional sales, and preferences by corporations in general assignments, show in how many ways and in what varied forms the legislature may properly restrain freedom of action in commercial transactions in order to promote the general welfare." The decision goes on to say further that "Such interference with liberty and such limitation upon the use of property, although arbitrary and inconvenient, have always been regarded as valid in order to prevent fraud and to promote justice. While commerce is hampered to a limited extent in some ways, it is protected and promoted to a much greater extent in other ways."

Court of Appeals decision in New York. With reference to the "freedom of contract" the

decision goes on to say: "Is freedom of contract interfered with more by requiring notice of creditors before certain sales are made than by forbidding certain other sales altogether? The statute is intended to interfere only with those who buy and sell in bad faith toward the creditors of the vendor. It doubtless interferes with some who act in good faith, but so do the other statutes referred to. In order to prevent injustice and fraud, legislation for time out of mind has placed some restraint upon commercial transactions, and where the legislature has jurisdiction to act the method of suppressing the evil is wholly within its sound discretion."

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